CLERK'S COPY.

TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1931

No. 337

WESTERN DISTRIBUTING COMPANY,
APPELLANT,

vs.

THE PUBLIC SERVICE COMMISSION OF THE STATE OF KANSAS ET AL.

APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE DISTRICT OF KANSAS

FILED AUGUST 31, 1931

(36,151)

(36,151)

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1931

No. 337

WESTERN DISTRIBUTING COMPANY, APPELLANT,

vs.

THE PUBLIC SERVICE COMMISSION OF THE STATE OF KANSAS ET AL.

APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE DISTRICT OF KANSAS

INDEX

	Original	Print
Record from district court of the United States, District of Kansas	1	1
Citation with acknowledgment of service (omitted in printing)	1	
Waiver of citation	2	1
Motion for preliminary injunction	3	2
Notice of hearing	4	2
Order setting down motions for hearing	4	3
Notice of hearing before three-judge court	5	3
Order overruling motion to dismiss, granting leave to file amended bill instanter, etc	8	6
Opinion on motion to dismiss, Phillips, J	9	8
Amended bill of complaint	14	12
Answer to amended bill of complaint	31	27
Decree	48	42

JUDD & DETWEILER (INC.), PRINTERS, WASHINGTON, D. C., DECEMBER 5, 1931

	Original	Print
Findings of facts	48	43
Conclusions of law	55	48
Opinion by Judge Phillips	57	50
Opinion by Judge Symes	60	53
Opinion by Judge Hopkins	64	56
Petition for appeal	68	59
Order allowing appeal	68	60
Assignment of errors	69	60
Bond of The Western Distributing Company on appeal (omitted in printing)	70	
Condensed statement of evidence essential to decision of questions presented on appeal	72	62
Testimony of Fred H. Rice	74	64
B. C. Adams	78	68
Fred H. Rice (recalled)	84	74
Statement and motion by Mr. Steiger	84	74
Affidavit of Thos. R. Weymouth	92	80
Floyd C. Brown	93	82
H. D. Hancock	96	84
Ed C. Connor	99	86
Approval by court	102	89
Præcipe for transcript	103	89
Clerk's certificate to transcript (omitted in printing)	104	
Statement of points to be relied upon and designation to print entire record	105	90

[fol. a] TRANSCRIPT OF RECORD

UNITED STATES SUPREME COURT

No. —

THE WESTERN DISTRIBUTING COMPANY, a Corporation, Appellant,

v.

THE PUBLIC SERVICE COMMISSION OF THE STATE OF KANSAS and J. W. Greenleaf, Chas. D. Shukers, and C. H. Montgomery and The City of Eldorado, Kansas, a Municipal Corporation, Appellees

Appeal from the District Court of the United States for the District of Kansas, First Division.

[fol. 1] Citation in usual form showing service on E. H. Hatcher, filed July, 24, 1931, omitted in printing.

[fol. 2] IN UNITED STATES DISTRICT COURT FOR THE DISTRICT OF KANSAS, FIRST DIVISION

No. 1391-N

THE WESTERN DISTRIBUTING COMPANY, a Corporation, Plaintiff,

v.

THE PUBLIC SERVICE COMMISSION OF THE STATE OF KANSAS and J. W. Greenleaf, Chas. D. Shukers, and C. H. Montgomery and The City of Eldorado, Kansas, a Municipal Corporation, Defendants

WAIVER OF CITATION—Filed July 24, 1931

The Western Distributing Company, having filed its assignment of errors, petition for appeal, and supersedeas bond, and having been allowed an appeal to review the above entitled cause in the Supreme Court of the United States, the said defendants, and each of them, by their

attorneys, do hereby waive the issuance and service of a citation herein and do hereby enter their appearances in the Supreme Court of the United States.

Dated this 24th day of July, 1931.

Chas. W. Steiger, E. H. Hatcher, Solicitors for Defendants and for Harry H. Woodring, Governor of the State of Kansas, and Roland Boynton, Attorney General of the State of Kansas.

[fol. 2½] [File endorsement omitted.]

[fol. 3] IN UNITED STATES DISTRICT COURT

[Title omitted]

MOTION FOR PRELIMINARY INJUNCTION—Filed March 19, 1931

Now comes The Western Distributing Company, a corporation, plaintiff in the above entitled case, by R. D. Garver and J. A. McClure and Robert Stone its solicitors, and moves the court to grant a writ of injunction against the defendants, and each of them, and their respective successors in office, deputies, clerks, attorneys, solicitors, and all persons acting under their authority, pending this suit and until the further order of the court, conformable to the prayer of the bill in said case filed.

Dated March 18, 1931.

The Western Distributing Company, a Corporation, by R. D. Garver, J. A. McClure, Robert Stone, Its Solicitors.

[fol. 4] IN UNITED STATES DISTRICT COURT

NOTICE OF HEARING—Filed March 19, 1931

To the Public Service Commission of the State of Kansas and J. W. Greenleaf, Chas. D. Shukers, and C. H. Montgomery and the City of Eldorado, Kansas, a municipal corporation, defendants in the above-entitled case, and their respective attorneys and solicitors:

Please take notice that the plaintiff in the above entitled action has filed its motion for preliminary injunction against you and each of you herein in accordance with the prayer

of said Bill of Complaint, and will call the same up for hearing before Honorable Richard J. Hopkins, Judge of said Court, at his chambers in the city of Wichita, Kansas, on the 23rd day of March, A. D., 1931, at the hour of ten o'clock A. M., or as soon thereafter as counsel may be heard, for the purpose of requesting him to cause to be assembled a three-judge court as by statute in such case made and provided.

R. D. Garver, J. A. McClure, Robert Stone, Its Solicitors.

Service of the above and foregoing is hereby acknowledged this 18th day of March, A. D. 1931.

Chas. W. Steiger.

IN UNITED STATES DISTRICT COURT

ORDER SETTING DOWN MOTIONS FOR HEARING ON APRIL 13, 1931—FILED APRIL 9, 1931

Now on this 8th day of April, 1931, the plaintiff and defendants having agreed thereto, it is hereby ordered, that the motion of the plaintiff for a temporary injunction and convening of a three judge court to hear the same, and the motion of the defendants to dismiss the Bill of Complaint, [fol. 5] be set for hearing on the 13th day of April, 1931, at Topeka, Kansas.

The Clerk of the Federal Court for the State of Kansas, Second Division, is hereby ordered to transfer all files pertaining to the above-entitled cause to the Clerk of the Federal Court for the State of Kansas, First Division, at Topeka, Kansas.

Richard J. Hopkins, Judge.

IN UNITED STATES DISTRICT COURT

NOTICE OF HEARING BEFORE THREE-JUDGE COURT—FILED MAY 18, 1931

To His Excellency Harry H. Woodring, Governor of the State of Kansas, and Hon. Roland Boynton, Attorney General of the State of Kansas, Greeting:

You, and each of you, are hereby notified that a session of the District Court of the United States for the District

of Kansas, First Division, has been duly assembled with three judges to be held in the United States District Court room in the city of Topeka, at ten o'clock A. M., on Friday, the 15th day of May, 1931, at which time there will be presented to the court and a hearing will be had on the application of The Western Distributing Company, a corporation, plaintiff in the above entitled action, wherein the Public Service Commission of the State of Kansas and others are parties defendant, for a temporary injunction to enjoin the defendants therein named from enforcing or attempting to enforce a certain order issued by them or their predecessors on August 17, 1920, respecting rates for natural gas in the City of Eldorado, Kansas, for the reason that said rates fixed in said order are unremunerative, unreasonable, and confiscatory, and that said order deprives the plaintiff of its property without due process of law, in violation of the provisions of the Fourteenth Amendment [fol. 6] to the Constitution of the United States. Involved in said hearing will also be the validity under the Constitution of the United States of Chapter 220 of the Laws of Kansas of 1929, prescribing the procedure to be followed to procure a review of the orders of the Public Service Commission of the State of Kansas. The allegations respecting said chapter, as set out in the bill of complaint filed in said cause, together with the prayer for relief, are as follows:

"Plaintiff further alleges that Chapter 220 of the Laws of Kansas of 1929, prescribing the procedure to be followed to procure a review of orders of said Commission, is unconstitutional and void for the following reasons:

(1) Said statute restricts the court reviewing the proceeding of said Commission to the record made before said Commission, and denies to the party aggrieved the right to introduce evidence according to established rules of evidence before a court of equity, said Commission being governed by no such rules, and admitting testimony without regard to the law of evidence or the practice in courts of equity.

(2) Said statute does not provide a clear, definite and adequate opportunity to present to a court of competent jurisdiction the order of said Commission complained of, nor afford the party aggrieved the opportunity to have a

court of competent jurisdiction exercise its independent judgment upon the questions of law and fact involved in said proceedings.

(3) By its terms; said statute requires the court to review the order of the Commission by consideration only of the facts as found by the Commission, thereby in effect attempting to confer upon the court legislative functions.

(4) Said statute by its terms would require the aggrieved party to resort only to some District Court of the State of Kansas for a review of the orders of the Commission complained of, thereby depriving it of its right to select its forum, and if it so desired, to resort to a federal court for an adjudication of its rights; for each and all of which reasons, said statute denies to the plaintiff due process of law and denies to the plaintiff an opportunity to have its controversy judicially determined and amounts to a denial of due process of law, in violation of the Constitution of the United States and especially of the Fourteenthe Amendment thereto.

[fol. 7] Wherefore, since plaintiff is without adequate remedy, save in the court of equity, it prays

A. That the said defendants, and each of them, and all persons acting through or under them be restrained and enjoined from the enforcement of said order of August 17, 1920, or the existing rates therein established;

B. That this court set this cause for hearing on application for temporary injunction at an early date and that upon said hearing, the court issue its injunction preliminary until final hearing and perpetual thereafter, and that pending the hearing of said temporary injunction, the court enter its restraining order with like effect;

C. That defendants, and each of them, be enjoined from in any manner or form interfering with plaintiff putting in reasonable rates until such time as some lawful authority approves a lawful schedule of rates;

D. That each and all of the defendants, their respective officers, attorneys, counsels, agents, and representatives, and their successors in office, be restrained and enjoined from commencing, instituting, or prosecuting in any other

court or tribunal any suit or proceeding to litigate any of the matters herein complained of, or arising or growing out of any of the transactions and matters herein alleged between this plaintiff and the defendants, or any of them, until the final determination of this suit.

E. That on said final hearing, that said restraining order and temporary injunction be made perpetual as aforesaid;

F. That the plaintiff have such other and further relief as may be just and equitable;

G. That there be issued out of this court a writ of subpœna to be served upon the defendants directing them, upon a certain day and under certain pain, to be and appear before this Honorable Court, then and there a full, direct, true and perfect answer to make in the premises, and further to stand to or by and perform such other and further things as may be conferred in equity and consider questions as to this court shall seem mete, and your plaintiff will ever pray."

Under the law providing for the assembling of such three-judge court, it is required that notice shall be served upon you, and each of you, in compliance with which this notice is hereby given.

Robert D. Garver, Robert Stone, Attorneys for Plaintiff.

[fol. 8] A copy of the foregoing notice was served by me upon Hon. Harry H. Woodring, Governor of the State of Kansas and upon Hon. Roland Boynton, Attorney General of the State of Kansas, upon the 5th day of May, 1931.

Robert Stone, Attorney for Plaintiff.

IN UNITED STATES DISTRICT COURT

ORDER OVERRULING MOTION TO DISMISS, GRANTING LEAVE TO FILE AMENDED BILL INSTANTER, ETC.—Filed May 19, 1931

Now on this 19th day of May, A. D., 1931, this cause came on to be heard at this term, upon the motion of the defend-

ants to dismiss the bill, the plaintiff appearing by its counsel, Robert D. Garver and Robert Stone; and the defendants appearing by their counsel C. W. Steiger, Earl H. Hatcher, and S. C. Bloss. The motion was argued by counsel and thereupon, upon consideration thereof

It is ordered, adjudged and decreed as follows:

The motion to dismiss is overruled and the plaintiff is given leave to file instanter its amended bill of complaint.

The defendants are given five (5) days in which to file their answer.

The cause also came on for hearing upon the application of the plaintiff for a preliminary injunction, and upon application of all parties said application was continued until ten o'clock A. M. on June 25, A. D. 1931. In the meantime, the plaintiff is directed to file its affidavits in support thereof within ten (10) days, copies to be served upon counsel for defendants; and the defendants are given ten (10) days thereafter in which to file counter affidavits, [fol. 9] and plaintiff given five (5) days thereafter in which to file affidavits in reply.

It is further ordered that upon any preliminary questions as to the sufficiency of the amended bill respecting the procedure before the defendant Commission that may arise under the answer, the parties shall stipulate upon the relevant facts appearing in the record of such proceedings, and defendants shall file their brief in respect thereto serving copies upon the plaintiff within ten (10) days from this date; and the plaintiff shall within ten (10) days thereafter file its brief in answer thereto, also serving copies upon the attorneys for defendants, who shall have five (5) days thereafter in which to file a reply brief.

Orie L. Phillips, Circuit Judge. J. Foster Symes.
Richard J. Hopkins, District Judges.

In United States District Court

Appearance:

For the plaintiff: Robert D. Garver and Robert Stone.
For the defendants: Earl H. Hatcher and S. C. Bloss.

Before Phillips, Circuit Judge, and Symes and Hopkins, District Judges

OPINION ON MOTION TO DISMISS—Filed June 3, 1931

PHILLIPS, Circuit Judge, delivered the opinion of the court:

Plaintiff is the owner of a gas distributing system for the distribution and sale of natural gas to domestic and industrial consumers within the city of Eldorado, Kansas. It brought this suit to enjoin the enforcement of an order of the Kansas Court of Industrial Relations, entered August 17, 1920, establishing rates for gas to be sold for domestic [fol. 10] purposes in the city of Eldorado.

In its bill, plaintiff alleged that, under such rates, it was unable to earn an adequate return on the fair value of its property used and useful in the services rendered by it in the city of Eldorado; and that such rates were confiscatory, and deprived plaintiff of its property without due process of law.

It further alleged that it filed an application with the Public Service Commission on July 30, 1929, in which it alleged that such rates were insufficient to produce a fair return on the fair value of its property, were unreasonable and unjust, and resulted in taking plaintiff's property without due process of law, and prayed that such commission fully investigate all matters pertaining to such rates and establish reasonable, just and equitable rates.

It further alleged that, after a hearing on such application, the Commission dismissed the same on the ground that plaintiff had failed to introduce evidence "proving to the satisfaction of the Commission the reasonableness of the price of 40 cents per thousand cubic feet paid by" plaintiff "to the Cities Service Gas Company at the city gate".

To the bill of complaint, defendants have interposed a motion to dismiss, setting up two principal grounds. While denominated a motion, this pleading, as the basis for the first ground thereof, alleges that, at the hearing before the commission, plaintiff failed and refused to introduce evidence of any kind showing the cost of services rendered to it by Henry L. Doherty & Company, for which it paid one and three-fourths per cent. of the gross revenue derived

by it from the sale of gas to the city of Eldorado, the cost of services rendered to it by the Gas Service Company, a holding company affiliated with plaintiff, and the cost of gas furnished to it by the Cities Service Gas Company, a holding company also affiliated with plaintiff. These facts do not appear on the fact of the bill.

For the second ground of their motion, defendants set up that plaintiff failed to exhaust the remedy provided by Sections 66-118 (c) and (d), 1930 Supp. to Rev. Stat. of [fol. 11] Kansas, 1923, being Sections 3 and 4 of Chap. 220 of the Session Laws of 1929, which are set out in marginal Note 1.

NOTE 1

Sec. 66-118c, supra.—"Within thirty (30) days after the application for a rehearing is denied, or if the application is granted, then within thirty (30) days after the rendition of the decision on rehearing, the applicant may apply to the district court of the county in which the order of the commission is to become effective for a review of such order or decision; if the order of the commission is to become effective in more than one county the application must be to the district court of one of such counties. The application for review shall be filed in the office of the clerk of the district court of the proper county and shall specifically state the grounds for review upon which the applicant relies and shall designate the order or decision sought to be reviewed. The clerk of the district court shall immediately serve a certified copy of said application upon the public service commission by transmitting a certified copy thereof by registered mail to the secretary of the public service commission at his office at the state capitol. The secretary shall immediately notify all parties who appeared in the proceeding before the Commission, by registered mail, that such application for review has been filed."

Sec. 66-118d, supra.—"The secretary upon receipt of said copy of the application for review shall forthwith transmit to the clerk of the district court in which the application for review has been filed, a certified transcript of all pleadings, applications, proceedings, orders or deci-

sions of the commission of the evidence heard by the commission on the hearings of the matter or cause; Provided That the parties, with the consent and approval of the commission, may stipulate in writing that only certain portions of the record be transcribed. Said proceedings for review shall be for the purpose of having the lawfulness or reasonableness of the original order or decision or the order or decision on rehearing inquired into and determined, and the district court hearing said cause shall have the power to vacate or set aside such order or decision on the ground that such order or decision is unlawful or unreasonable. After the said transcript shall be filed in the office of the clerk of the district court of the county in which the application is filed, the judge of said district court may, on his motion, or on application of any parties interested therein, make an order fixing a time for the filing of abstracts and briefs and shall fix a day for the hearing of such cause. All proceedings under this section shall have precedence in any court in which they may be pending, and the hearing of the cause shall be by the court without the intervention of a jury. The procedure upon the trial of such proceedings in the district court and upon appeal to the supreme court of this state shall be the same as in other civil actions, except as herein provided. No court of this state shall have power to set aside, modify or vacate any order or decision of the commission, except as herein provided."

[fol. 12] Counsel for the defendants contend that they should be permitted to establish by affidavits the facts upon which the first ground of their motion is predicated. The court is of the opinion that the better practice would be to set up such facts in either the bill or answer, so that the legal questions presented thereby may be clearly drawn in issue. These facts, if true, will present, at the very threshold of this law suit, an important legal question going to the right of plaintiff to maintain its suit. Such facts, therefore, should be set up in either the bill or answer and the question disposed of at the earliest possible date.

Coming to the second proposition raised by the motion, it will be observed that the statutes of Kansas in force prior to the adoption of Chap. 220, supra, provided that a public utility, dissatisfied with an order of the commis-

sion fixing a rate, might commence, within thirty days from the making of such order, an action in any court of competent jurisdiction against the Commission seeking to vacate and set aside such order, on the ground that the findings, valuation or rate of the Commission made or fixed therein were unlawful or reasonable. See Sections 66-118 (c) and (d), supra.

In the recent case of Wichita Gas Co. v. Public Service Commission, 132 Kas. 459, the court held that the review under Sections 66-118 (c) and (d), supra, was limited to questions of law and that the court could not set aside a finding of fact if there was any evidence before the Commission to sustain it.

It is settled law that an order of a state commission fixing maximum future rates to be charged by a utility violates the due process clause of the federal constitution, if no fair opportunity is provided by the state law for submitting the question, as to whether the rates are confiscatory, to the determination of a judic-al tribunal upon its own independent judgment as to both law and fact. Ohio Valley Water Co. v. Ben Avon Borough et al., 253 U. S. 287.

Counsel for defendants assert that Sections 66-118 (c) and (d), supra, furnish an exclusive remedy for reviewing [fol. 13] the order of the Commission and that plaintiff, having invoked the jurisdiction of the Commission to set aside an existing rate and to establish a fair rate, is now estopped to question the constitutionality of such sections. The construction urged by counsel for defendants would render these sections unconstitutional, since they make no provisions for judicial review of questions of fact.

It is well settled that if a statute is susceptible of two constructions, one of which will render it constitutional and the other unconstitutional, it is the duty of the court to adopt that construction which, without doing violence to the fair meaning of the language, will render it valid. 12 C. J. p. 788.

Section 66-118c, supra, provides that "the applicant *may* apply to the district court * * * for a review of such order or decisions" of the Commission. (Italics ours.) "May", in its ordinary sense, means that which is permissive, not mandatory.

Since the language of the Act permits of the construction that it provides an alternative, elective remedy and such a construction will render it constitutional we so construe it and overrule the second ground of the motion to dismiss.

We may observe, in passing, that if the facts set out in support of the first ground of the motion to dismiss are true, then the questions of the reasonableness of the forty cent rate at the city gates, and of the charges made by Henry L. Doherty & Company and the Gas Service Company are proper subjects of inquiry, both before the Commission and the court, in determining the reasonableness of the rates to be charged by plaintiff. Smith v. Illinois Bell Tel. Co., 282 U. S. 133.

[fol. 14] IN UNITED STATES DISTRICT COURT

AMENDED BILL OF COMPLAINT—Filed May 19, 1932

Comes now the Western Distributing Company, a corporation, and alleges:

I

Plaintiff is a corporation, duly organized, incorporated and existing under and by virtue of the laws of the State of West Virginia, with its principal office and place of business in the City of Eldorado, Kansas, and is duly authorized and admitted to do business in the State of Kansas.

II

The Public Service Commission of the State of Kansas is a legislative and administrative body, created by the laws of the State of Kansas, having its office and principal place of business in the City of Topeka, Kansas, and is within the jurisdiction of this court. The defendants, J. W. Greenleaf, Chas. D. Shukers, and C. H. Montgomery, at all times complained of herein, have assumed to act as members of said Commission. The city of Eldorado is a municipal corporation, organized as a city of the second class, under and by virtue of the laws of the State of Kansas.

III

The plaintiff is a resident and citizen of the State of West Virginia, and each and all of the defendants are residents and citizens of the State of Kansas. The amount in controversy herein is more than three thousand dollars ($3,000.00), exclusive of interest and costs.

IV

Plaintiff is without adequate remedy at law.

V

Plaintiff is now, and at all times complained of herein has been, the owner of a gas distributing system for the supply, distribution, and sale of natural gas to domestic and industrial consumers within the city of Eldorado, duly authorized to do business under the jurisdiction of the Public Service Commission of the State of Kansas.

[fol. 15]

VI

Plaintiff alleges that on the 17th day of August, 1920, The Court of Industrial Relations of the State of Kansas, it being the then body authorized by the laws of the State of Kansas to regulate and establish rates for public utilities in the State, after a full hearing under its Docket No. 2,978, established rates for gas to be sold for domestic purposes in the city of Eldorado, said rate consisting of certain fixed charges graduated according to the demand of the several consumers in said city and commodity charge of 32c per thousand cubic feet of gas sold and delivered per month as follows:

Demand per cubic feet per hour	Customer's charge per month
30	$1.25
45	1.65
60	2.25
75	2.75
90	3.50
120	5.00
180	7.50
300	12.00

VII

Said schedule of rates so established by said order of The Court of Industrial Relations of August 17, 1920, remained in effect from the date of said order during all the times of interest herein and is the only rate now established and authorized by said Court of Industrial Relations, or its successor, The Public Service Commission of the State of Kansas, the defendant herein.

Said rate has never produced for plaintiff an adequate return on the fair value of its property, used and useful in the service rendered by it in the city of Eldorado, and at the present time and for a number of years last past has failed to produce the actual operating expenses reasonably and necessarily incurred by plaintiff in the operation of said property, with nothing whatever for depreciation or return.

The present fair value of plaintiff's property, used and useful in the service rendered by it in the city of Eldorado is at least the sum of $288,442.00.

[fol. 16]

VIII

Plaintiff does not own or produce any natural gas for its supply to meet the requirements of its customers in the city of Eldorado, but is required to purchase gas from others having a supply adequate for its use, and at the present time is procuring its supply from the Cities Service Gas Company and paying therefor the price of 40c per thousand cubic feet at the city gate of said city, said company having the only supply known to plaintiff adequate for the needs of said distribution system. Plaintiff is unable to procure a supply of gas for said system from any other source or at a price lower than that now being paid by it to the Cities Service Gas Company. Said price is a fair and reasonable price.

IX

On October 28, 1925, the city of Wichita filed its complaint with the defendant, The Public Service Commission of the State of Kansas, asking for an investigation of rates being charged by plaintiff in the City of Wichita and the establishment of just and reasonable rates, said

proceeding being docketed by said Commission as Docket No. 7,801; hearings were had before said Commission and on June 18th, 1926, said Commission handed down its order in which existing rates were set aside and a new schedule of rates promulgated. Said The Wichita Gas Company, being dissatisfied with the schedule of rates so established by said Commission on July 9th, 1926, filed in the District Court of Shawnee County, Kansas, a suit in equity in which it alleged that the rates established by the Public Service Commission in its order of June 18th, 1926, were unreasonable, unjust and confiscatory and in which suit a permanent injunction was asked against said Commission enjoining it from putting said schedule of rates into effect. On September 30th, 1926, by the order of said Court, T. M. Lillard of the Shawnee County Bar was duly appointed Referee to take testimony and make findings of fact and conclusions of law and report the same to the court. Numerous hearings were duly had before said Referee and on February 7th, 1927, said Referee duly [fol. 17] filed his report with said court in which report it was found that the rates promulgated by said Commission were unreasonable, unjust and confiscatory and it was recommended by said Referee that the enforcement of the same should be enjoined; exceptions were duly filed to the report and a hearing on such exceptions was duly had before the Court. On June 18, 1927, judgment was entered by said court approving and accepting the report of the Referee and permanently enjoining said Commission from enforcing the rates promulgated in its order of June 18th, 1926, and setting aside said order and also permanently enjoining the enforcement of the rates in effect at the time said order of June 18th, 1926, was entered; that by said injunction all rates theretofore in effect by the plaintiff company were set aside and there being no rate in existence plaintiff, in July, 1927, put into effect and filed with said Commission a new schedule of rates of its own making.

X

On July 16, 1927, the defendant, the Public Service Commission, duly appealed to the Supreme Court of Kansas from the judgment of the District Court of Shawnee County, Kansas, entered on June 18, 1927, and on the

9th day of June, 1928, the Supreme Court handed down its opinion affirming the judgment of the District Court of June 18, 1927.

XI

In said hearing before T. M. Lillard, Esquire, and in the hearing before the said District Court, one of the essential questions at issue was whether or not the price of gas delivered by the Cities Service Gas Company to the distributing company at Wichita, to-wit: 40c, was a fair and reasonable rate and should be allowed as a proper item of cost in determining the rate to domestic consumers charged by the distributing company in the city of Wichita. Evidence was offered in said cause and the court determined that said rate of 40¢ was fair and reasonable; was not discriminatory, and should be allowed as a proper item of cost in determining the fair and reasonable rate charged by said distributing company to the domestic consumers in the city of Wichita. The defendants herein were parties [fol. 18] to said suit and the judgment rendered by the court amounted to was an adjudication against the defendants herein upon said issue, and in the absence of a substantial change in the conditions is binding upon the said defendants. Plaintiff alleges that conditions are in all essential particulars identical with the conditions at the time of the entry of said judgment, except that since that time Cities Service Gas Company has expended many hundreds of thousands of dollars for additional pipe line and equipment for supplying such gas. The cost of delivery of gas at the gates of the city of Eldorado was and is at least as great as delivery of gas at the gates of the city of Wichita.

XII

On July 27, 1927, the city of Wichita, without waiting for a decision by the Supreme Court of Kansas on appeal above referred to, filed another application with said Public Service Commission asking for an investigation of the schedule of rates established by the Wichita Gas Company, being the distributing company for the city of Wichita, in July, 1927, pursuant to the injunction granted by the District Court of Shawnee County, Kansas, in the suit above referred to. Hearings were had upon said application

and the matter was taken under advisement by the Commission. Thereafter, and on August 10, 1928, shortly after the decision of the Supreme Court affirming the judgment of the District Court of Shawnee County, Kansas, the defendant, The Public Service Commission, handed down its order refusing to approve the rates then in effect and establishing a new schedule of rates for the Wichita Gas Company. Thereupon, being dissatisfied with said order, The Wichita Gas Company filed its bill in equity in the United States District Court for the District of Kansas, wherein the Public Service Commission of the State of Kansas and the individuals then constituting the Public Service Commission of the State of Kansas, and the City of Wichita were made defendants, said cause being docketed in said court as No. 1171-N in equity. In said bill, it was alleged that the rates promulgated by the defendant [fol. 19] Commission in its order of August 10, 1928, were unreasonable, unjust, unlawful and confiscatory and asked that the defendants therein, and each of them, be enjoined from enforcing said order; that on November 16, 1928, J. D. M. Hamilton of the Shawnee County Bar was duly appointed special master by said court, with directions to take testimony and report his findings of fact and conclusions of law to said Court. Hearings were duly had before said special master and all parties to said proceeding were given an opportunity to introduce all competent evidence bearing upon the issues involved; said proceeding was closed and on January 13, 1930, said special master duly filed his report with said court in which report it was found that the rates promulgated by said defendant Commission in its order of August 10th, 1928, were unlawful, unjust, and confiscatory and in said report it was recommended that the said rates be permanently enjoined. On January 30th, 1930, said defendant Commission duly filed its exceptions to said master's report.

Thereafter, the report of said special master was presented to the United States District Court for the District of Kansas, and after consideration by said court was approved and adopted, and judgment entered in accordance therewith. In said suit numbered 1171-N, one of the issues was whether or not the city gate rate of 40¢ per thousand

cubic feet delivered by this plaintiff to the Wichita Gas Company at the city gate in Wichita was a fair and reasonable rate, and whether or not it should be allowed as a proper item of cost in determining the rate to be charged to domestic consumers in the city of Wichita. Evidence was offered in respect thereto from which it was shown that said rate of 40¢ at the city gate was established by the Public Service Commission of the State of Kansas in its order of March 21, 1923; that said rate had thereafter been maintained and had not been increased although the pipeline investment of this plaintiff was almost double its investment of 1923. It was also shown that the same rate was being charged to the other distributing companies upon the system of Cities Service Gas Company and that a similar rate was being charged by the Lone Star Gas Company [fol. 20] to distributing companies in Texas on a shorter haul than that of Cities Service Gas Company. Evidence was introduced showing that at that time, to-wit: November, 1928, the reasonable value of the system of the Cities Service Gas Company was more than $83,000,000.00 and that the rate of 40¢ to the city gate of the several distributing companies would make a return of less than eight per cent (8%) on the reasonable value of the property of Cities Service Gas Company, used and useful in said srvice. It was, however, urged by the Public Service Commission and by the city of Wichita that gas could be procured from other producers at a less rate than 40¢. In order to ascertain whether or not that was a fact, the United States District Court suspended judgment to give the defendants in said cause an opportunity if possible to procure a bona fide offer of gas at a lesser rate than 40¢. Whereupon, it appeared that the defendants were unable to procure any offer or proposition for the furnishing of gas at any lower rate, and the decree of the court as aforesaid was thereupon entered in said United States District Court. Said judgment and decree of said court was not appealed from and became the final order of the court in said cause.

XIII

Plaintiff being dissatisfied with the rates established by the order of August 17, 1920, as aforesaid, on the 30th day of July, 1929, filed with the defendant Commission its

application in which it alleged that the rates then in effect were insufficient to produce a fair return for all purposes on the fair value of plaintiff's property and that the same were unreasonable and unjust, and resulted in the taking of plaintiff's property without due process of law and denied to it the equal protection of the law, all in violation of the laws of the State of Kansas and the Fourteenth Amendment to the Constitution of the United States, and asked said Commission to fully investigate all matters pertaining to such rates and that reasonable, just and equitable rates be established.

Said application came on for hearing on the 7th and 8th [fol. 21] days of January, 1931, on which days the hearing was had in the city of Wichita, Kansas, and at which time plaintiff introduced evidence in support of its application and during the course of which proceedings the Commission requested plaintiff to furnish to it certain additional evidence in regard to specific matters at issue; that at the conclusion of the hearing on January 8, 1931, plaintiff rested, and attorneys for the Commission and the city of Eldorado requested a continuance in order to enable them to examine the voluminous exhibits introduced by witnesses for plaintiff and to give them an opportunity to cross-examine thereon; that pursuant to such request said hearing was adjourned by the Commission to January 21, 1931.

That on January 21, 1931, the parties appeared as before and plaintiff produced witnesses and introduced evidence covering all matters theretofore requested by the Commission; that after introducing such evidence and exhibits, plaintiff again rested; that neither the attorneys for the Commission nor for the city of Eldorado cross-examined plaintiff's witnesses as to the testimony and exhibits theretofore introduced nor asked for any additional evidence or any evidence in addition to that already introduced pertaining to the reasonableness of the 40¢ city gate rate nor the cost thereof to the pipeline company, but instead interposed a motion to dismiss said proceeding as hereinafter alleged.

That in the proceedings had in this court in the case of City of Wichita vs. Public Service Commission, et al, hereinbefore referred to, and in connection with the motion of the defendant Commission to retax costs and assess part

of the costs to plaintiff, the then attorney of record for the Commission in said proceeding contended to the court that the plaintiff had benefitted by the litigation in that it had procured an adjudication of the propriety and reasonableness of the 40¢ city gate rate, the administration charge of 1¾% paid to Henry L. Doherty & Company, and the expenses of Gas Service Company allocated to the Eldorado property, and in open court stated that the Com- [fol. 22] mission would abide by the decision of the court and accept it as a starting point in future rate cases before it; that replying on said statement and promise, the court taxed part of the costs to plaintiff reciting in its written memorandum opinion:

"I am advised that *to* Public Service Commission is satisfied to take as a starting point the findings of the two courts upon the fundamental questions involved";

that in the proceedings had before the Commission on the 7th and 8th day of January, 1931, plaintiff assumed that the Commission would adhere to its expressed promise to abide by the decision of this court and assumed that it could take the decision of this court rendered less than four (4) months previous to said hearing as a starting point; that accordingly, plaintiff offered in evidence the decisions of this court and of the Supreme Court of Kansas; that said offers were objected to by the attorney for the Commission; that Commissioner Montgomery presiding at said hearing then stated:

"The Commission will take notice of those decisions. The objection will be sustained";

that plaintiff thereupon introduced evidence substantially as follows: that there was no other source of supply; that no gas had ever been offered at a cheaper rate; that the plaintiff would purchase cheaper gas if offered by any other company; that the cost of bringing gas to the city gate had not altered greatly for quite a few years; that it cost just as much now as fifteen or sixteen years ago; that there has been no change in the city gate rate since 1923; that in the opinion of an expert witness based on the valuation and financial experience of the pipeline company as shown in this court, the 40¢ gate rate was reasonable; that

all cities on the Cities Service Gas Company system receive their supply from a common source; that the price is the same as to all cities not having local gas; that an effort was made to find local gas available to Eldorado but none was found; that the president of the company had information as to the investment and earnings of Cities Service Gas Company and from what he had heard it was not earning a fair return; that the 40¢ rate was established, [fol. 23] to encourage gas operators to go farther for an adequate supply; that at the time the 40¢ gate rate was established, all the larger distributing companies such as the two Kansas Cities, Topeka, Wichita, Hutchinson and Newton were not owned or in any manner associated with Cities Service Gas Company; that no change has been made in the city gate rate since the properties in those cities were acquired; that the city gate rate was established by the Kansas Commission in 1923; that there has been a change in conditions that might make the rate unreasonably low; that the Western Distributing Company had tried to get a lower rate from Cities Service Gas Company but could not; that the properties at Lawrence, Leavenworth, Atchison and other towns are owned by outside interests and pay 40¢ at the city gate the same as affiliated companies.

That there was no request from the Commission for any additional showing as to the 40¢ gate rate, and the applicant rested. That attorneys for the city and the Commission asked for an adjournment to give them time to examine applicant's exhibits and to cross-examine plaintiff's witnesses thereon, and a continuance was taken to January 21, 1931.

That numerous requests for additional evidence were made by the Commission in the hearings had on January 7th and 8th, and on January 21st the plaintiff put on witnesses furnishing all evidence requested by the Commission there having been no request made however as to any additional showing in regard to city gate rate, and plaintiff believing that no further showing was desired by the Commission because the rate had originally been established by the Commission itself and under the statutes of Kansas (Section 66-115, R. S. Kansas 1923), was prima facie reasonable because of the prior adjudication by the Supreme Court of Kansas and by this court, and the agree-

ment of the Commission to accept the decision of this court as a starting point, and because of the further fact that the Commission at that time had pending in this court cause numbered 1354-N In Equity entitled Public Service Commission of the State of Kansas and the State of Kansas, ex rel. Roland Boynton, Attorney General of the State of [fol. 24] Kansas vs. Cities Service Gas Company, in the petition in which case it had alleged that the rate was "excessive, unreasonable and unwarranted under the law" and asked this court to make an investigation of the same on the grounds and for the reason that the Commission

"can have adequate relief only in this Honorable Court"

and in that connection further alleging that the defendant therein was engaged

"in the business of a gas pipeline company purchasing, selling and transporting natural gas by pipeline in Interstate Commerce in and through Kansas and other States of the United States, and as such Interstate Commerce Agency is subject to and governed by the principles of common law operative upon such interstate commerce transactions as the common law has not been modified by Congressional enactments in so far as it pertains to Interstate Commerce by gas pipeline companies,"

and for the reason that plaintiff did not believe that said defendant Commission would in said proceeding undertake to decide an issue concerning which it had in effect alleged that it had no jurisdiction and concerning which it was an active partisan in other litigation.

That plaintiff introduced similar evidence in regard to the 1¾% administration charge of Henry L. Doherty & Company and the allocated expense of Gas Service Company, and introduced all evidence requested by the Commission in regard thereto refusing only to permit the Commission through the accounting firm of C. L. Montgomery, one of the defendant Commissioners, to examine the books of the Gas Service Company this court having refused such permission in the previous litigation on the ground that such examination was unnecessary and would serve no useful purpose.

That the 1¾% administration charge paid to Henry L. Doherty & Company for the period then under considera-

tion by the Commission amounted to the sum of $3,454.43 and the expenses of the Gas Service Company charged to the property at Eldorado amounted to the sum of $5,970,11, or a total of $9,424.54 all of which could have been disallowed by the Commission without affecting the right of plaintiff to the relief asked for the reason that its [fol. 25] actual operation deficit under the undisputed evidence exceeded the sum of $20,000.00 for said period.

That after introducing the evidence requested by the Commission on the 21st of January, 1931, plaintiff again rested.

Thereupon, the attorney for said defendant Commission moved that plaintiff's application be dismissed on the ground that it had failed to introduce evidence proving to the satisfaction of the Commission the reasonableness of the price of 40¢ per 1,000 cubic feet being paid by it to Cities Service Gas Company at the city gate of said city notwithstanding the fact that the reasonableness of said rate had been adjudicated by the Supreme Court of Kansas and by this court as hereinbefore alleged, and the Commission had agreed to use that adjudication as a starting point in future rate cases, and notwithstanding the fact that the undisputed evidence of applicant was that no change in conditions had taken place since said adjudication and that said rate was reasonable, and notwithstanding the fact that said rate was established by said Commission and under the laws of the State of Kansas was prima facie reasonable.

That plaintiff was entirely surprised by said motion, there having been no request for any additional showing and no refusal to comply with any request of the Commission as to evidence regarding the city gate rate, and such procedure being heretofore unknown to the practice of said Commission as is evident from said motion itself, the same being in part as follows:

"Mr. Steiger (Attorney for the Commission): May it please the Commission, at this time the attorneys for the Commission desire to present a matter to the Commission which has never been presented in like manner in my experience with the Commission, or has it ever been presented in like form in the past, so far as my knowledge and experience goes. * * * There is absolutely nothing in this evidence upon which you can predicate an order that the gas at the city gate is fair and reasonable, and there

is no evidence at all showing any cost of that service to the Western Distributing Company, the *the* Supreme Court has directed the lower court to ascertain in the Illinois Bell Telephone case."

That plaintiff had been led to believe by the conduct of the Commission that it would not be required to put in evidence other than was introduced in regard to the gate rate [fol. 26] as the Commission had advised it that as to the twenty-two other applications pending before the Commission as to other cities served by plaintiff,

"I (Commissioner Montgomery) imagine we could set several of the smaller ones for a day.";

thereby in effect stating that as to the other applications several of them could be heard in one day, whereas if evidence were required as to the valuation of the pipeline system, its financial experience, and the cost to it of rendering service to the city of Eldorado were required, such evidence would alone consume many days.

The plaintiff is informed and believes that an inventory valuation of the pipeline system of the Cities Service Gas Company would require the time of expert engineers for many months, and would incur an expense of not less than $100,000.00, and that an audit of the books of said company would require an additional expenditure of many thousands of dollars, and that if such a showing as is now apparently demanded by the Commission were required in each rate case without regard to the size of the city involved, the expense would be absolutely prohibitive.

XIV

In said proceedings had before said defendant Commission, as aforesaid, the city of Eldorado appeared by its city attorney and other officials, cross examined the witnesses of plaintiff, joined in the motion to dismiss, and announced that said city desired to be considered as a part to said proceeding and subsequent litigation, if any, all of which was consented to by plaintiff.

XV

Said defendant Commission sustained the motion of its attorney and of the city of Eldorado to dismiss plaintiff's

application for the reasons above recited, and denied plaintiff the relief sought in the said application and denied to it a reasonable schedule of rates to be charged in said city, or a schedule of rates which would permit plaintiff to earn any sum whatever over operating expenses on the [fol. 27] fair value of its property, and thereby required it to continue under existing rates which fail in the sum of approximately $40,000.00 per year to produce a return sufficient to pay operating expenses without anything whatever for return or depreciation.

XVI

Within ten days after the sustaining of said motion and the denial of the relief sought in plaintiff's application, it filed with said Commission its application for rehearing, which application for rehearing was upon the day after it was filed denied by said defendant Commission without affording the plaintiff an opportunity to present the same or be heard thereon, and without notice to it that the same was to be considered or decided.

XVII

For the year ending November 30, 1930, the actual experience of plaintiff under the rate now in effect showed its gross earnings from the sale of gas for all purposes to be the sum of $197,394.64 and its actual expenses for the operation and maintenance of its said property during said *property* to have been $283,049.07, leaving a deficit of $40,654.42, in which sum it failed to make its actual and necessary operating expenses. If said rate is continued in effect, plaintiff will continue to lose approximately the same amount annually for which reason said rate results in the taking of plaintiff's property and the use thereof without due process of law and denies to it the equal protection of law, all in violation of the Constitution of the United States, and especially of the Fourteenth Amendment.

XVIII

Plaintiff further alleges that Chapter 220 of the laws of Kansas of 1929, prescribing the procedure to be followed to procure a review of orders of said Commission, is unconstitutional and void for the following reasons:

(1) Said statute restricts the court reviewing the proceeding of said Commission to the record made before said [fol. 28] Commission, and denies to the party aggrieved the right to introduce evidence according to established rules of evidence before a court of equity, said Commission being governed by no such rules, and admitting testimony without regard to the law of evidence or the practice in courts of equity.

(2) Said statute does not provide a clear, definite, and adequate opportunity to present to a court of competent jurisdiction the order of said Commission complained of, nor afford the party aggrieved the opportunity to have a court of competent jurisdiction exercise its independent judgment upon the question of law and fact involved in said proceedings.

(3) By its terms, said statute requires the court to review the order of the Commission by consideration only of the facts as found by the Commission, thereby in effect attempting to confer upon the court legislative functions.

(4) Said statute by its terms would require the aggrieved party to resort only to some District Court of the State of Kansas for a review of the orders of the Commission complained of, thereby depriving it of its right to select its forum, and if it so desired, to resort to a federal court for an adjudication of its rights;

for each and all of which reasons, said statute denies to the plaintiff due process of law and denies to the plaintiff an opportunity to have its controversy judicially determined and amounts to a denial of due process of law, in violation of the Constitution of the United States and especially of the Fourteenth Amendment thereto.

Wherefore, since plaintiff is without adequate remedy, save in the court of equity, it prays

A. That the said defendants, and each of them, and all [fol. 29] persons acting through or under them be restrained and enjoined from the enforcement of said order of August 17, 1920, or the existing rates therein established;

B. That this court set this cause for hearing on application for temporary injunction at an early date and that upon said hearing, the court issue its injunction prelimi-

nary until final hearing and perpetual thereafter, and that pending the hearing of said temporary injunction, the court enter its restraining order with like effect;

C. That defendants, and each of them be enjoined from in any manner or form interfering with plaintiff putting in reasonable rates until such time as some lawful authority approved a lawful schedule of rates;

D. That each and all of the defendants, their respective officers, attorneys, counsels, agents and representatives, and their successors in office, be restrained and enjoined from commencing, instituting, or prosecuting in any other court or tribunal any suit or proceedings to litigate any of the matters herein complained of, or arising or growing out of any of the transactions and matters herein alleged between this plaintiff and the defendants, or any of them, until the final determination of this suit;

E. That on said final hearing, that said restraining order and temporary injunction be made perpetual as aforesaid;

F. That the plaintiff have such other and further relief as may be just and equitable;

G. That there be issued out of this court a writ of subpoena to be served upon the defendants, directing them, upon a certain day and under certain pain, to be and appear before this Honorable Court, then and there a full, direct, true, and perfect answer to make in the premises, and further to stand to or by and perform such other and further things as may be conferred in equity and consider questions as to this court shall seem mete, and your plaintiff will ever pray.

[fol. 30] R. D. Garver, Robert Stone, Attorneys for Plaintiff. Stone, McClure, Webb & Johnson, of Counsel.

Duly sworn to by Robert Stone. Jurat omitted in printing.

[fol. 31] IN UNITED STATES DISTRICT COURT

ANSWER TO AMENDED BILL OF COMPLAINT—Filed May 25, 1931

The joint and several answer of The Public Service Commission of the State of Kansas, J. W. Greenleaf and Thur-

man Hill, substituted as defendant as the successor in office for C. H. Montgomery and the City of Eldorado, Kansas, a municipal corporation, to the amended bill of complaint of The Western Distributing Company, a corporation, plaintiff.

These defendants now and at all times hereafter, saving and reserving to themselves and each of them all benefit and advantages of exception, which can or may be had or taken to the many errors, uncertainties and other imperfections in the said plaintiff's bill of complaint contained, for answer thereunto or unto so much and such parts thereof as these defendants are advised is or are material or necessary for them to make answer unto, they, these defendants, severally answering, say:

I

They admit the allegations of paragraph I of said Bill of Complaint.

II

They admit the allegations of paragraph II of said Bill of Complaint, except that and these defendants further say that since the filing of the Bill of Complaint herein, the term of office of defendant, C. H. Montgomery, has expired and he has been succeeded in office by Thurman Hill, who, together with said J. W. Gree[illegible]af, are the duly appointed, [fol. 32] qualified and acting [illegible]missioners who constitute the Public Service Commission of the State of Kansas according to the laws of said state relating thereto.

III

They admit the allegations of paragraph III of said Bill of Complaint.

IV

They deny and it is not true that plaintiff is without adequate remedy at law as alleged in paragraph IV of its Bill of Complaint, and these defendants submit and aver that all and every of the matters in plaintiff's Bill of Complaint mentioned and complained of are matters which may be tried and determined at law, and as provided in:

"An Act relating to public utilities and common carriers, providing for rehearings and for review of orders

and decisions of the Public Service Commission, and repealing Section 66-118 of the Revised Statutes of 1923 and all acts and parts of acts in conflict herewith," being Chapter 220 of the "Laws of Kansas, 1929," in force and effect now and since February 23, 1929, and appearing as Sections 66-118a to 66-118o inclusive, 1930 Supplement to Revised Statutes of Kansas, 1923."

And further answering the claim of plaintiff that it is without adequate remedy at law these defendants aver that at the hearings before The Public Service Commission for the State of Kansas at Wichita, as referred to in paragraph XIII of plaintiff's Bill of Complaint herein, it appeared to said Commission from evidence produced, offered and received on behalf of plaintiff:

1. That the stock of plaintiff was actually owned by Gas Service Company, a corporation, a holding company.

2. The capital stock of the said, Gas Service Company, is owned by the Cities Service Company.

[fol. 33] 3. The capital stock of the said Cities Service Gas Company, is owned by The Empire Gas and Fuel Company, a corporation, whose capital stock is owned by the Cities Service Company, a corporation.

4. The Cities Service Company is the common owner of the plaintiff, The Western Distributing Company and the other companies named above, and the property and earnings of each of these companies go to make up the value of the stock of Cities Service Company.

5. Henry L. Doherty, an individual, doing business at the City of New York as Henry L. Doherty & Company, through arrangements with the Cities Service Company, dominates, manages and controls, for substantial compensation, the operations of all of these companies, both in their relations with the public and between themselves.

6. That Henry L. Doherty, doing business at the City of New York as Henry L. Doherty & Company, Cities Service Company, Empire Gas and Fuel Company, Cities Service Gas Company, Gas Service Company and the plaintiff, The Western Distributing Company, are, in fact, associated and affiliated companies; that through and by means of

stock ownership and management contracts with each of the companies herein set forth, said Henry L. Doherty & Company dictates and manages and controls the directors of each of said corporations, and manages and controls the internal affairs and operations of each of said corporations and their relations and business dealings with each other; that the Western Distributing Company, the plaintiff herein, is subsidiary of each of the corporations hereinabove named and more particularly, with reference to the operation and maintenance of the Eldorado natural gas distributing plant by the Western Distributing Company, [fol. 34] the said Western Distributing Company is subsidiary of Henry L. Doherty & Company, aforesaid, Gas Service Company and Cities Service Company.

7. That the plaintiff, The Western Distributing Company, at Eldorado, buys its supply of natural gas from Cities Service Gas Company, above named. That said Cities Service Gas Company transports through its pipelines natural gas under agreement with the said Western Distributing Company and delivers said natural gas for distribution locally in Eldorado by the Western Distributing Company for an agreed consideration per M cubic feet of natural gas furnished which amount paid by plaintiff company, to Cities Service Gas Company, is by plaintiff company charged as a part of the costs of operating its plant, such amount paid and to be paid by the said Western Distributing Company to the said Cities Service Gas Company, being in large and substantial amounts as appeared from the evidence. Through the organization of the Cities Service Company and the domination, management and control of Henry L. Doherty & Company, the Cities Service Gas Company occupies a special position with particular advantages in relation to the production, transportation and sale of natural gas to the affiliated and subsidiary companies of the Cities Service Group hereinabove described and referred to, and particularly to the plaintiff, the Western Distributing Compnay, at Eldorado, Kansas.

8. The Gas Service Company operated and manages the Western Distributing Company and keeps the books of the said Western Distributing Company in Kansas City, Missouri, and charges to the said plaintiff company large lump

sums annually purporting to be the plaintiff's share of expenses of the Gas Service Company.

9. The Western Distributing Company from its gross receipts at Eldorado pays 1¾% of its revenue to Henry [fol. 35] L. Doherty & Company under a proposal relating to certain services purported to be performed for it by Henry L. Doherty & Company. The said amount paid to Henry L. Doherty & Company, and the amount paid to the Gas Service Company by the Western Distributing Company, plaintiff herein, were together large and substantial parts of the gross revenue of said Western Distributing Company from the operations of its plant at Eldorado and charged to operating costs.

10. That it is the duty of the defendant, the Public Service Commission for the State of Kansas, to establish just and reasonable rates for natural gas furnished to the city of Eldorado and its inhabitants for all purposes; and it is the duty of said Public Service Commission to make express findings of fact upon which to base any order establishing just and reasonable rates; that at the hearing hereinbefore referred to, it plainly appeared to the Commission, and it was and is true that large and substantial portions of the gross receipts from the sale of natural gas were paid by the plaintiff, Western Distributing Company, as operating costs to Henry L. Doherty & Company under agreement, as hereinbefore stated; to Cities Service Gas Company for natural gas furnished; to the Gas Service Company at Kansas City, Missouri, for purported management expenses. That in order to determine what at Eldorado is and should be a just and reasonable rate for natural gas sold, furnished and delivered by the plaintiff company it was necessary for this Commission to find and determine the fact as to the cost of operating plaintiff's plant at Eldorado and under the facts of relationship existing between Henry L. Doherty & Company, the Gas Service Company, the Cities Service Gas Company and the plaintiff, determine the cost of the service rendered and gas furnished [fol. 36] to plaintiff company by each of said companies above named, for which payments were made to them and charged to operating costs by the plaintiff; and further determine and find the fact as to the rate of profit earned

by the said associated companies, to-wit, Henry L. Doherty & Company, Gas Service Company and Cities Service Gas Company, under the contracts whereby they respectively purported to furnish the services and gas above referred to to the plaintiff company.

11. That the said plaintiff company at the hearings referred to, nor at any other time or place, did not furnish to the Public Service Commission, defendant herein, any evidence, facts or information upon which this defendant could base any finding as to the costs of the services rendered by Henry L. Doherty & Company under the management and operation of the Eldorado plant of plaintiff, or any evidence from which this answering defendant could determine the rate of profit earned by the said Henry L. Doherty & Company on account of the furnishing of such services; nor did the plaintiff at any time or place furnish to this answering defendant, the Public Service Commission for the State of Kansas, any evidence, facts or information as to the cost or rate of profit earned by either the Gas Service Company of Kansas City on account of its operation and management of the plaintiff company, nor of the cost or rate of profit earned by the Cities Service Gas Company on account of natural gas furnished to the Eldorado plant of plaintiff from its pipe lines, and from the evidence, information and facts before said Commission, your answering defendant, it was wholly unable to make findings of fact as required by law upon said essential matters.

12. That the applicant, the Western Distributing Company, through its officers and employees, who are also offi- [fol. 37] cers and employees, under the facts as hereinbefore stated, of the Gas Service Company, Henry L. Doherty & Company and the Cities Service Gas Company, having in its possession and control books, records and other evidence showing the cost, if any, of performing the purported services, and the cost of producing, buying and transporting gas to plaintiff's plant at Eldorado, failed and refused to produce such evidence and refused to produce it or make such data available to this answering defendant, when such evidence in the possession and under the control of the plaintiff would, if produced, furnish to

this defendant facts upon which to base findings as to the cost of purported services rendered and gas furnished and rate of profit earned by the said Henry L. Doherty & Company, Gas Service Company and the Cities Service Gas Company, on account of the contracts and agreements with plaintiff hereinbefore referred to with reference to the purported services and gas furnished to its Eldorado plant; and said plaintiff failed and neglected and refused to produce any evidence, facts or information to this answering defendant Commission, as to whether or not claimed charges for purported services rendered to the Eldorado plant by Henry L. Doherty & Company and by the Gas Service Company were identical, or any evidence to define specifically the particular services rendered, sufficient to enable your answering Commission to make findings of fact with reference thereto.

V

Defendants admit the allegations of paragraph V of said Bill of Complaint.

VI

Defendants admit the allegations of paragraph VI of plaintiff's Bill of Complaint.

[fol. 38]

VII

Defendants admit that the schedule of rates established by the order of August 17, 1920, referred to in paragraph VI of said Bill of Complaint, remained in effect from the date of said order and is now the only rate established and authorized by law. Said defendants, further answering, deny that said rate has never produced for plaintiff an adequate return on the fair value of its property, used and useful in the service rendered by it in the City of Eldorado, and deny that at the present time and for a number of years last past, said rate has failed to produce actual operating expenses, reasonably and necessarily incurred by plaintiff in the operation of said property, and these defendants further deny that the present fair value of plaintiff's property used and useful in service rendered by it in the City of Eldorado, is at least the sum of $288,442.00;

and further answering, these defendants aver that the value of plaintiff's property in said City of Eldorado, devoted to the public purpose of supplying said city and its inhabitants with natural gas, is substantially less than the valuation claimed by the plaintiff and defendants further say that with reasonable and necessary operating expenses paid from the gross revenue of said Eldorado plant, with the lawful present rates as hereinbefore stated, in effect, the said property of plaintiff at Eldorado would net to it a reasonable return upon its investment.

VIII

These defendants admit that plaintiff as a legal entity does not own or produce any natural gas for its supply to meet the requirements of its customers in the City of Eldorado, and admit that it is required to purchase gas from others having a supply adequate for its use, and at the present time is procuring its supply from the Cities Service Gas Company and paying therefore, as these defendants are informed and believe, the price of forty (40) cents per thousand cubic feet at the city gate of said city, and further answering, said defendants say that they have no such information as will enable them to affirm or deny the allegation that said company, the Cities Service Gas Company, has the only supply known to plaintiff adequate for the [fol. 39] needs of said distribution system, and defendants have no information sufficient to enable them to affirm or deny the allegation that plaintiff is unable to supply gas from said system from any other source, at a price lower than the price now being paid by it to the Cities Service Gas Company, but defendants are informed and believe, and so aver, that said plaintiff has made no reasonable or diligent effort to secure a supply of gas sufficient to furnish natural gas to Eldorado and its citizens from any other company than the Cities Service Gas Company and at any price lower than the said rate of 40 cents per 1000 cubic feet of gas furnished at the city gates; and these defendants, further answering, aver that the said price of 40 cents per thousand cubic feet at the city gates is not a fair and is not a reasonable price for the gas so furnished. And these defendants, answering further, say that while it is true that plaintiff as a legal entity does not own or produce

any natural gas for its supply to the City of Eldorado, by and through and in conjunction with its associate, the Cities Service Gas Company, and as a subsidiary to such company as hereinbefore more fully set forth, it is in control of a natural gas supply for said City of Eldorado.

IX

Defendants admit the allegations of fact made in paragraph IX of plaintiff's Bill of Complaint herein, but deny that any of the orders or judgments in said paragraph IX had any relation to the rate schedule for the City of Eldorado, nor to the plaintiff herein.

X

Defendants admit the facts stated in paragraph X of plaintiff's Bill of Complaint, but deny that the judgment therein referred to, or the opinion of the Supreme Court of Kansas therein referred to, (Wichita Gas Company v. Public Service Commission, 126 Kansas, 220) had any effect or bearing on the matters now in controversy between plaintiff and defendants.

XI

Defendants admit that in the said litigation with the Wichita Gas Company, hereinbefore referred to, one of the [fol. 40] issues was whether or not 40 cents was a fair and reasonable rate for pipeline gas and should be allowed as a proper item of cost in determining the rate to domestic consumers to be charged in the City of Wichita, but these defendants aver that in said litigation no more was determined than that forty cents was being charged as the pipeline rate and that there was no evidence sufficient to show that said rate was unreasonable. Defendants deny that plaintiff was a party to said suit and deny that defendant, the City of Eldorado, was a party to said suit and deny that the orders, findings or judgment made in the litigation hereinbefore referred to had any effect or bearing upon the question of reasonable charges or reasonable rates to be in force and effect for gas sold by the plaintiff to the City of Eldorado or its inhabitants.

These defendants, further answering, say: That said pipeline rate of 40 cents was not then, and has not been since said time, and is not now a reasonable rate for pipeline gas at the city gates of the City of Eldorado; and these defendants specifically deny that conditions are in all essential particulars identical with the conditions at the time of the entering of said judgment, and aver that there has been and that there is now in process a general decline in prices for the gas purchased, or to be purchased, materials used in the construction of plant and labor in making such construction, and in operating plants constructed; and these defendants deny that the cost of delivery of gas at the gates of the City of Eldorado was and is as great as the cost of delivery of gas at the gates of the City of Wichita.

Further answering these defendants say: That they have no information sufficient either to affirm or deny the statement that Cities Service Gas Company has expended many hundreds of thousands of dollars for additional pipeline and equipment for the supply of gas; that plaintiff refused and refuses to supply the defendant, the Public Service Commission of Kansas, with any information as to the cost of the service performed by the pipeline company, an associate and subsidiary company of plaintiff, or any information as to the net profits or earnings of said pipeline company by reason of any alleged performance of service to [fol. 41] plaintiff in supplying any of said cities with natural gas as hereinbefore fully stated.

XII

Defendants admit the allegations of paragraph XII of plaintiff's Bill of Complaint, but these defendants further aver that neither the plaintiff nor the City of Eldorado was a party to said litigation in the Federal Court for the District of Kansas, known herein as No. 1171-N in equity; and further aver that neither the judgment nor any finding of fact in such controversy is available either to plaintiff or defendant in relation to the controversy as to reasonable, fair and just rates in the City of Eldorado; and defendants further aver that since the date of said judgment referred to in said paragraph XII there have been marked declines in the price of labor, material and of gas, and large developments in proven gas areas making available,

for use at the City of Eldorado, a greatly increased supply of natural gas without any commensurate increase in the cost of production and distribution thereof.

XIII

Defendants admit that plaintiff on the 30th day of July, 1929, filed with defendant, the Public Service Commission for the State of Kansas, its application for an increase in rates at Eldorado, as stated in said Bill of Complaint, but defendants deny that said Commission did not set said application generally for hearing or give the applicant the opportunity to be heard thereon until the 7th day of January, 1931, but aver that said application was at all times set for hearing in accordance with the rules duly established by said Public Service Commission and that continuances were asked for and given to plaintiff in this case to permit its engineers and accountants to obtain data to sustain its application. And further answering these defendants admit that a hearing was had in the City of Wichita, Kansas, on the 7th day of January, 1931, and that plaintiff introduced certain evidence in support of its said application and that the hearing was adjourned to the 21st day of January, 1931, at which time plaintiff again appeared before said defendant Commission and intro- [fol. 42] duced further evidence in support of its said application and rested. These defendants further answering say: That all the evidence and the evidence as a whole presented by the said applicant plaintiff herein wholly failed to prove or to tend to prove any sufficient state of facts which the said Public Service Commission of the State of Kansas must by law find before said Commission is able to find that the rate is fair, reasonable or just, or unfair, unreasonable or unjust. Said insufficiency of evidence and the nature thereof being fully hereinbefore set forth and explained in defendants' answer to paragraph IV of plaintiff's Bill of Complaint herein.

As to the allegations referring to proceedings in this court with reference to the retaxation of costs in the City of Wichita case, and with reference to the statements of the then attorney of record for the Public Service Commission as to benefits to the Commission and as to future use by the Commission of such alleged benefits, these defendants have no knowledge other than as disclosed by the

record in such cause or in the records in the causes referred to. It is admitted that the defendant, Public Service Commission, should and did take notice of the decision referred to and the respective records, but it is averred that the defendant, City of Eldorado, had and has no knowledge thereof.

These defendants deny that evidence was introduced showing or tending to show that changed conditions might make the rate unreasonably low, and deny that there was no request from the Commission for any additional showing as to the 40 cent gate rate, and aver that plaintiff did not comply with requests for additional evidence.

Defendants admit that the 40 cent gate rate was established heretofore by this Commission, but long prior to the application of the plaintiff herein such order was by the Commission vacated and the plaintiff had knowledge thereof long prior to the time it made its application to this commission.

Defendants admit Case No. 1354-N was pending in this court, and aver that such cause was pending when plaintiff made its application for increased rates, but such cause was dismissed on motion of the Commission; that neither [fol. 43] the plaintiff herein nor the City of Eldorado was a party thereto. These defendants have no knowledge as to whether or not plaintiff did not believe the Commission would consider the question of a reasonable pipeline rate for gas in determining a sum to be allowed as operating costs.

Defendants deny that plaintiff introduced similar evidence in regard to the 1¾% administration charge of Henry L. Doherty & Company and the allocated expense of Gas Service Company, and deny that plaintiff introduced all evidence requested by the Commission; and aver that it was the duty of the plaintiff to introduce evidence to enable the Commission to make findings of fact as to costs of all services claimed to be rendered by said parties referred to, the costs of gas furnished and the net profits of each company affiliated and associated with plaintiff arising out of transactions with plaintiff. And defendants aver that plaintiff failed and neglected to introduce such evidence although requested so to do.

Defendants deny that the actual operation deficit under the undisputed evidence exceeded the sum of $20,000 for

said period, and aver that the amounts paid Henry L. Doherty & Company to Gas Service Company for management and the amount paid for natural gas taken by plaintiff, was and is material to enable the Commission to make necessary findings of fact.

Defendants deny that the Commission had agreed to use the reasonableness of the 40 cent gate rate paid to the Cities Service Gas Company as determined in other litigations as a starting point in future rate cases. Defendants deny that the undisputed evidence showed that no change in conditions had taken place and deny that the said rate was at the time or is reasonable, and deny that said gate rate is one established by said Commission effective under any order then or now in force, or that said rate was or is prima facie reasonable.

Defendants deny that plaintiff had been led to believe by the conduct of the Commission that it would not be required to put in evidence other than that introduced in regard to the gate rate, but have no knowledge as to whether or not plaintiff was entirely surprised by said motion to dismiss. [fol. 44] These defendants are not advised and have no knowledge as to the costs of producing all the evidence upon each matter upon which this Commission is under the law required to make a finding, but aver that such costs would not be unreasonable and that all such evidence is under the control of and could be produced by plaintiff.

XIV

Defendants admit that in the proceeding before the Public Service Commission of Kansas, as aforesaid, the City of Eldorado appeared by its city attorney and other officials, cross-examined certain witness of plaintiff and joined in the motion to dismiss, but these defendants deny that said City of Eldorado desired to be considered as a party to subsequent litigation if any, or that consent was given by plaintiff.

XV

Defendants admit that the Public Service Commission for Kansas sustained the motion of its attorney and of the City of Eldorado to dismiss the plaintiff's application for the reasons as fully set forth in defendants' an-

swer to paragraph IV hereof, but these defendants deny that the said Public Service Commission denied to plaintiff a reasonable schedule of rates which would permit plaintiff to earn a reasonable sum over operating expenses on the fair value of its property and thereby compelled it to continue under existing rates which fail in the sum of approximately $40,000 per year to bring a return sufficient to pay operating expenses without anything whatever for return or depreciation; and these defendants specifically deny that plaintiff under the rates in effect at Eldorado is failing in any sum to produce a reasonable return upon the fair value of its property used and useful over and above its necessary, reasonable, operating expenses and reasonable depreciation.

XVI

These defendants admit that within ten days after the sustaining of the motion to dismiss plaintiff's application, [fol. 45] it filed with the Commission its application for a re-hearing and that said application for a re-hearing was upon the day after it was filed denied by said defendant Commission, but defendants aver and deny that said application for a re-hearing was overruled without affording plaintiff an opportunity to be present or to be heard thereon and without notice to it that the same was to be considered and decided but upon the understanding that plaintiff would not produce any further testimony as to the cost of services to plaintiff's plant at Eldorado furnished by Henry L. Doherty & Company, the Gas Service Company and Cities Service Gas Company, or any further evidence as to the net earnings of said last-named companies arising out of their transactions and contracts with the said plaintiff's plant at Eldorado in furnishing services charged for as operating costs, and or as fully set forth heretofore in defendants' answer to paragraph IV of this Bill of Complaint. And these defendants have been and are at all times willing to give to plaintiff a fair and reasonable hearing and opportunity to present the evidence as to costs and net earnings hereinbefore set forth to enable the Public Service Commission for the State of Kansas to make such findings of fact as to the fair value of the Eldorado plant of plaintiff, its fair and reasonable

operating costs, and as to what is a fair and reasonable return for the use of its properties at Eldorado devoted to public use.

XVII

Defendants admit that for the year ending November 30, 1930, the gross earnings from the sale of gas for all purposes at Eldorado was the sum of $197,394.64. Further answering, defendants say: They have no knowledge or information as to the costs of the operation and maintenance of the Eldorado property and no knowledge or information as to any deficit arising from the operations of the Eldorado plant, but these defendants deny that if the rate now in effect should be continued in effect that plaintiff will lose any sum from the operation of said plant, or that plaintiff's property and the use thereof has been, is or would be taken, without due process of law and aver that there would be no denial to plaintiff of the [fol. 46] equal protection of law in violation of the fourteenth amendment to the Constitution of the United States.

XVIII

These defendants deny that Chapter 220 of the "Laws of Kansas, 1929," referred to in paragraph XVIII of plaintiff's Bill of Complaint, is unconstitutional and void, and deny that said statute for any reason denies to plaintiff due process of law or an opportunity to have its controversy judicially determined in violation of the Constitution of the United States and the Fourteenth Amendment thereto.

Wherefore defendants, having answered all and singular those parts of the Bill of Complaint material and necessary to answer, pray that notwithstanding it has answered all and various allegations of the Bill of Complaint that the court dismiss the Bill of Complaint, for the reason and on the ground that it plainly appears from averments therein contained that said suit has been prematurely brought without procuring all of the remedies at law available to plaintiff, before allowing the trial of the various described questions in the suit. But these answering defendants save and reserve to themselves all of their rights

in the presentation of evidence and request a hearing upon the matters of the issues of fact and law involved in this cause in the event it should be determined that said Bill of Complaint be not dismissed for want of equity appearing therein; and further defendants pray that plaintiffs take nothing by reason of the allegations in this said Bill of Complaint, that no restraining order or temporary injunction be granted herein, nor thereafter made perpetual, but that these defendants be hence dismissed with reasonable costs and charges.

R. T. McCluggage, S. C. Bloss, Chas. W. Steiger, E. H. Hatcher, Attorneys for Defendants.

[fol. 47] *Duly sworn to by E. H. Hatcher. Jurat omitted in printing.*

[fol. 48] IN UNITED STATES DISTRICT COURT

DECREE—Filed June 26, 1931

This cause came on to be further heard at this term, plaintiff appearing by R. D. Garver and Robert Stone, its counsel, and the defendants appearing by R. T. McCluggage, S. C. Bloss, Chas. W. Steiger, and E. H. Hatcher, its counsel, and is argued by counsel.

Thereupon upon consideration thereof it was ordered, adjudged and decreed as follows:

That the application for a preliminary injunction be denied and said cause be dismissed; and the plaintiff announcing in open court that it elected to stand upon its bill of complaint and the evidence introduced on the preliminary questions of law submitted, it is hereby ordered and decreed that the plaintiff recover nothing under its bill of complaint and judgment be entered in favor of said defendants for their costs herein.

Orie L. Phillips, Circuit Judge. J. Foster Symes, Richard J. Hopkins, District Judges.

To which decree the plaintiff objects and is allowed an exception.

IN UNITED STATES DISTRICT COURT

FINDINGS OF FACTS—Filed June 26, 1931

I

The plaintiff, The Western Distributing Company, is a corporation duly organized, incorporated and existing under and by virtue of the laws of the State of West Virginia with its principal office and place of business in the City of Eldorado, Kansas, and is duly admitted and authorized to do business in the State of Kansas.

[fol. 49]

II

The Public Service Commission of the State of Kansas is a legislative and administrative body created by the laws of said state, having its office and principal place of business in the City of Topeka, Kansas, and is within the jurisdiction of this court.

The City of Eldorado is a municipal corporation, organized as a city of the second class, under and by virtue of the laws of the State of Kansas.

III

The amount in controversy herein is more than three thousand dollars ($3,000.00), exclusive of interest and costs.

IV

Plaintiff is the owner of a gas distribution system for the supply, distribution and sale of natural gas to domestic and industrial consumers in the City of Eldorado. Its common stock is owned by Gas Service Company, a corporation, with offices in Kansas City, Missouri. The capital stock of Gas Service Company is owned by Cities Service Company, a corporation, with headquarters at 60 Wall Street, New York City, New York.

V

The Cities Service Gas Company is a corporation organized under the laws of the State of Delaware, and duly authorized to transact business in the State of Kansas. It owns and operates fields in Texas, Oklahoma, and Kansas,

and pipe-lines etc. to points in those states and in Missouri and Nebraska, and is engaged in the business of producing and purchasing natural gas and transporting the same in interstate commerce and selling the same to the Western Distributing Company at Eldorado, Kansas, and many other distributing companies in the several states in which it operates. It is successor to The Kansas Natural Gas Company which formerly owned and operated part of its present system. The common stock of The Cities Service Gas Company is owned by the Empire Gas & Fuel Company, a corporation, and a control of the capital stock of said Empire Gas & Fuel Company is owned by the Cities Service Company.

[fol. 50] VI

The Western Distributing Company has received its supply of gas for the City of Eldorado at all times of interest herein from the Cities Service Gas Company and its predecessors. It does not produce or manufacture gas and has no supply available to it other than that of the Cities Service Gas Company.

VII

The rate charged by the Cities Service Gas Company for gas delivered to the plaintiff at Eldorado, Kansas, for domestic purposes is 40 cents per thousand cubic feet at the city gate; that the Public Utilities Commission of the State of Kansas undertook to establish such rate by its order dated March 21, 1923, and to set it aside by order dated October 20, 1924; that since March 21, 1923, the distributing companies at all cities served by the transportation system of the Cities Service Gas Company in Kansas, Missouri, and Nebraska, except as to cities having available a local supply of gas, have paid such rate at the city gates by private agreement.

At the time this rate was put into effect in 1923, the distributing companies in the major portion of the market supplied by the then pipeline system were not affiliated with Cities Service Gas Company or the pipeline company, and did not become so affiliated until after the year 1924, and no change in rates has since resulted from such affiliation. No written contracts covering any period of time

are in effect between the Cities Service Gas Company and the affiliated distributing companies, and all gas is sold and delivered under an oral day to day agreement at the price above stated.

VII-a

Plaintiff respectfully requests the court to make the following additional finding as a part of finding No. VII:

The reasonableness of this rate was found and adjudicated by the Supreme Court of Kansas as to the City of Wichita, Kansas, in the case of City of Wichita v. Public [fol. 51] Service Commission, said decision being reported in 126 Kansas 220; —— Pacific ——, and by this court in case numbered 1171-N, in Equity, final decree of which was entered in September, 1930. It is admitted by the pleadings that in this last mentioned proceeding, evidence was introduced showing that in November, 1928, the reasonable value of the system of the Cities Service Gas Company was more than $83,000,000.00 and that the rate of 40 cents per thousand cubic feet for gas sold for domestic purposes to the several distributing companies served by the pipeline system would make a return to the pipeline company of less than eight per cent (8%) on such valuation.

Refused. J. Foster Symes.

To which refusal plaintiff objects and is allowed an exception.

VIII

The rates charged by the plaintiff in the City of Eldorado were established by an order of the Court of Industrial Relations of the State of Kansas, it being the body then authorized by the laws of Kansas to regulate and establish rates for public utilities, by its order dated August 17, 1920. Being dissatisfied with the rates so established, plaintiff on July 30, 1929, filed with the defendant Commission its application in which it alleged that the rates then in effect were insufficient to produce a fair return for all purposes on the fair value of plaintiff's property, and that the same were unreasonable and unjust and resulted in the taking of plaintiff's property without due process of law and denied to it the equal pro-

tection of the law in violation of the laws of the State of Kansas and the 14th Amendment to the Constitution of the United States, and asked said Commission to fully investigate all matters pertaining to such rate, and that reasonable, just and equitable rates be established.

[fol. 52]

IX

Said application was duly heard by said defendant Commission, at which time it is admitted by the parties hereto that applicant's evidence was sufficient to make a prima facie case upon all issues except as to three items of its operating expenses, to-wit:

1. A payment of $3,454.43, being 1¼% of its gross revenue, paid to Henry L. Doherty & Company.

2. The sum of $5,970.11 paid to the Gas Service *Service* Company.

3. The cost of gas purchased from the Cities Service Gas Company at a total cost of $176,260.32, under the above mentioned city gate rate.

X

Assuming that the rate at the city gate is reasonable, Items 1 and 2 of Finding IX could be eliminated without affecting plaintiff's right to relief and would not be necessary to a determination of the question here presented, for the reason that under the showing made by the plaintiff it is failing to make its operating expenses by an amount greatly in excess of the total of said items.

XI

As to item 3 of Finding IX, cost of gas at the city gate, plaintiff introduced in evidence before the Commission the decision of the Supreme Court of Kansas and the decision of this court hereinabove referred to; and other evidence tending to show that there was no other source of supply than that of the Cities Service Gas Company; that no gas had ever been offered at a cheaper rate; that the plaintiff would have purchased cheaper gas if offered by any other company; that the cost of bringing gas to the city gate had not altered greatly for quite a few years; that there had been

no change in the city gate rate since 1923; that there had been no material change in the situation since the decision of the Supreme Court of Kansas and of this court above referred to; that all cities on the Cities Service Gas Com- [fol. 53] pany system receive their supply from a common source; that the price is the same as to all cities not having local gas; that an effort was made to find local gas available to Eldorado but none was found; that at the time the 40 cent gate rate was established all the larger distributing companies such as the two Kansas Cities, Topeka, Wichita, Hutchinson, and Newton were not owned or in any manner affiliated with the Cities Service Gas Company; that no change has been made in the city gate rate since the properties in those cities were acquired, and that the properties at Lawrence, Leavenworth, Atchison, and other towns are now owned by outside interests and pay 40 cents at the city gate the same as affiliated companies. Plaintiff refused to introduce evidence or make any showing as to the cost of gas to the Cities Service Gas Company at the city gate of Eldorado, Kansas, and refused to offer any testimony to show whether or not the Cities Service Gas Company was making an excessive or undue profit on gas sold to the plaintiff other than the adjudication hereinbefore referred to.

XII

Plaintiff's application before the defendant Commission was dismissed and it was denied the relief prayed for solely on the ground that it had failed to justify its operating expenses as to the three items set out in Finding IX hereof. A motion for rehearing as provided by the Kansas statute was filed and overruled by the defendant Commission.

XIII

At the hearing it was stipulated and agreed by the Commission through its counsel for the purposes of this hearing only, that the territory served by the pipeline company could not be segregated into separate zones for the purpose of fixing different costs of gas at the city gates in different zones.

Orie L. Phillips, Circuit Judge. J. Foster Symes, Richard J. Hopkins, District Judges.

[fol. 54] I respectfully dissent from the refusal of the court to make requested finding No. VII a. The decision in Wichita v. Public Service Commission, 126, Kan. 220, and in Wichita Gas Company v. Public Service Commission, this court No. 1171-N Equity, were offered in evidence before the Commission and the Commission announced that it would take notice of such decisions. The Commission had agreed at the time the decree was entered in Equity No. 1171-N, in connection with the assessment of the costs in such case, to take that decision as a starting point in future rate cases. I think the decisions had an evidentiary value before the Commission, and that they at least have a bearing upon the question of the good faith of the plaintiff in presenting its case before the Commission. The other facts set forth in the pleading are pleaded in the complaint and admitted by the answer and simply show that the finding in case No. 1171-N Equity, as to the reasonableness of the forty cent rate, was based upon substantial evidence.

Orie L. Phillips.

[fol. 55] IN UNITED STATES DISTRICT COURT

CONCLUSIONS OF LAW—Filed June 26, 1931

1. That the court has jurisdiction of the parties to and the subject-matter of this action.

2. That a public utility must first exhaust its remedy before the Public Service Commission before it may seek judicial relief by way of injunction.

3. That the plaintiff in support of its application before the defendant for an increase of gas rates in Eldorado must show that the price it pays for gas at the city gate, and that Items 1 and 2 of Finding 9, were fair and reasonable.

That the price paid for gas at the city gate is an element to be considered and determined by the defendant in passing upon the application.

4. That the plaintiff failed to exhaust its administrative remedy before the Commission.

5. That the complaint should be dismissed at the cost of the plaintiff. To each of which conclusions of law the plaintiff at the time objected and is allowed an exception.

PHILLIPS, Circuit Judge:

I think Conclusion of Law No. 3 should be amplified to more clearly show the theory upon which this court disposed of the case. The pipe line company which transports the gas from the source of supply located in other states to the city gate at Eldorado is engaged in interstate commerce. It is well settled that the Commission has no power to fix or regulate interstate rates. The rate at the city gate is an interstate rate. It does not follow, however, that the [fol. 56] Commission may not inquire into the reasonableness of the rate at the city gate for the purpose of fixing the local rates at Eldorado. It is my oipnion that the Commission in making inquiry into the rate at the city gate should approach the question not as it would were it empowered to fix that rate, but for the purpose of determining whether or not the contract between the affiliated company that brings the gas to the city gate and there sells and delivers it to its subsidiary is fair and reasonable and such as prudent business men would make under the existing facts and circumstances. In other words, the inquiry should be, Is it such a contract as the plaintiff would make if it were dealing at arm's length with a corporation with which it was in nowise related through stock ownership? To put it another way, it is my view, that while the Commission cannot directly or indirectly fix the rate of an interstate carrier, it may determine whether or not the subsidiary is paying the affiliated company an unfair charge for the gas at the city gate and using that charge as one of the items of operating cost upon which it seeks to have the local rate fixed. It is my opinion, therefore, that Conclusion of Law No. 3 should be substantially as follows:

"3. That it was incumbent upon plaintiff to introduce evidence before the Commission sufficient to make a showing that each of the three items of operating costs enumerated and set out in finding of fact No. 9 were just and reasonable and that the contracts therefor were such that a corporation represented by prudent officers dealing at

arm's length with a corporation to which it was in nowise related through stock ownership, under all the existing facts and circumstances, would enter into and not unduly favorable to Henry L. Doherty and Company, Gas Service Company, Cities Service Gas Company and Cities Service Company, or any of them, as a result of their control through stock ownership of the plaintiff company and that the plaintiff failed to make such showing."

[fol. 57] SYMES, District Judge:

I do not disagree with Judge Phillips' statement. It is my view, however, that at this stage of the proceedings the case must go back to the Public Service Commission which in the first instance is charged with the duty of determining whether the price paid by the plaintiff for gas at the city gate is fair and reasonable, and the method of determining the same. If, after it has performed this duty and made findings, the plaintiff feels aggrieved, it may then come to this court and ask it to pass upon the price and the methods adopted in arriving at the same, in so far as the same raises a federal question.

HOPKINS, District Judge:

I concur in the views of Judge Phillips, except as suggested by Judge Symes, with whose views I concur.

Orie L. Phillips, J. Foster Symes, Richard J. Hopkins.

IN UNITED STATES DISTRICT COURT

Appearances:

For the plaintiff: Mr. Robert D. Garver and Mr. Robert Stone.

For the defendants: Mr. Earl H. Hatcher, Mr. S. C. Bloss, and C. W. Steiger.

Before Phillips, Circuit Judge, and Symes and Hopkins, District Judges

OPINION BY JUDGE PHILLIPS—Filed July 3, 1931

PHILLIPS, Circuit Judge:

The allegations of the amended complaint, the amended answer, and the evidence introduced this morning present

the question: Has plaintiff sufficiently exhausted its administrative remedy to entitle it to seek judicial relief in this proceeding?

[fol. 58] On August 17, 1920, the Court of Industrial Relations of Kansas, after a hearing, established domestic gas rates in the city of Eldorado. Such rates have since remained in effect.

On July 30, 1929, plaintiff filed with the Public Service Commission of Kansas, successor to such Court of Industrial Relations, an application to set aside such rates and to establish new rates, in which it alleged that the rates fixed in such order of August 17, 1920, were insufficient to produce a fair and adequate return on the fair value of its property used and useful in the services rendered by it in the city of Eldorado; and that the rates fixed in such order were unreasonable, unjust, and confiscatory, and resulted in the taking of plaintiff's property without due process of law.

During the course of the hearing the commission requested plaintiff to furnish evidence relative to the reasonableness of the forty-cent gate rate which plaintiff paid to the Cities Service Gas Company for the gas which plaintiff distributed and sold in the city of Eldorado, and the charges paid by plaintiff to Henry L. Doherty & Company and the Gas Service Company for services rendered by such companies to plaintiff. Plaintiff offered no evidence before the commission as to the reasonableness of such items of cost, except the judgment and records in the two rate cases referred to in plaintiff's amended bill. The commission dismissed the application on account of the failure of plaintiff to produce satisfactory evidence upon such items of cost.

While I am not as certain on this point as my associates, Judge Symes and Judge Hopkins, I am inclined to agree with them that there was not a sufficient showing before the Commission with respect to the reasonableness of the amount paid for gas at the city gate, and the amounts paid for services to Henry L. Doherty & Company and the Gas Service Company to warrant the conclusion that plaintiff exhausted its administrative remedy before the commission.

[fol. 59] The stock of plaintiff is owned by the Gas Service Company. The Cities Service Company owns the stock

of the Gas Service Company. The stock of the Cities Service Gas Company is owned by the Empire Gas & Fuel Company. The stock of the latter company is owned by the Cities Service Company. Henry L. Doherty & Company through agency contracts manages and controls the operation of all these interrelated and affiliated companies. Counsel for plaintiff contend that, if the position of the commission be sustained, it will result in the commission indirectly fixing interstate rates.

The Cities Service Gas Company transports gas by means of pipe-lines from gas fields located outside of the state of Kansas to the city gate at Eldorado, and is engaged in interstate commerce. It has been settled by repeated decisions of the Supreme Court that the commission has no power to fix and regulate interstate gas rates. Missouri v. Kansas Gas Co., 265 U. S. 298; Peoples Natural Gas Co. v. Public Service Comm., 270 U. S. 550; Public Utilities Comm. v. Attleboro S. & E. Co., 273 U. S. 83.

It cannot be questioned that the forty-cent rate at the city gate is an interstate rate which the commission cannot directly regulate. It does not follow, however, that the commission may not inquire into the reasonableness of that rate for the purpose of fixing the local rates which plaintiff may charge in the city of Eldorado. Smith v. Illinois Bell Tel. Co., 282 U. S. 133; Houston v. Southwestern Bell Tel. Co., 259 U. S. 318; Southwestern Bell Tel. Co. v. Pub. Ser. Comm., 262 U. S. 276. It is my opinion that the commission, in making inquiry into the city gate rate, should not approach that question as it would were it empowered to fix such rate. The inquiry should be for the purpose of determining whether the contract between plaintiff and the Cities Service Gas Company, an affiliated corporation, is [fol. 60] fair and reasonable, and such as prudent business men acting in good faith and in the exercise of a sound discretion would have entered into under similar circumstances. To put it another way: The commission may not fix an interstate rate, but it may determine whether a corporation buying gas from a related and affiliated corporation is paying such affiliated corporation an unfair and fictitious charge, under the existing circumstances, for gas at the city gate, and using that charge as one of the elements of cost upon which it seeks to have the local rate

fixed. The commission may make inquiry into value of property, costs, profits, limitation on source of supply, and other pertinent factors in determining whether, under the existing circumstances, the contract is fair and reasonable and was made in good faith; but it may not go to the extent of fixing and determining the rate at the city gate.

The motion to dismiss contained in the answer is sustained. Counsel may prepare and submit to the court today findings of fact and conclusions of law in compliance with this ruling.

IN UNITED STATES DISTRICT COURT

OPINION BY JUDGE SYMES—Filed July 3, 1931

SYMES, District Judge (from the bench):

The motion to dismiss should be granted. This is, in effect, an appeal from an order of the state Public Service Commission dismissing plaintiff's application for an increase in gas rates in Eldorado. The record discloses that the plaintiff did not exhaust its remedy before that body, so has no standing here.

The plaintiff, a West Virginia corporation, owns a gas distributing system in the town of Eldorado, Kansas, and retails natural gas to local consumers. Its local rates were fixed by an order of the Court of Industrial Relations of Kansas—a body then authorized to establish rates for pub- [fol. 61] lic utilities—on August 17, 1920. It operated under this order for several years. Becoming dissatisfied, on July 30, 1929, it filed its application for an increase with the defendant commission, making the usual allegations that the rate then in effect was insufficient to produce a fair return; that its property was being taken without due process, etc., and asking the commission to investigate and establish a just and equitable rate.

At the hearing it developed that plaintiff did not produce or manufacture gas, but purchased its supply at the city gate from the Cities Service Gas Company under a day to day verbal contract, at 40 cents per thousand cubic feet—a rate established originally by the Public Utilities Commission of Kansas on March 21, 1923.

It is admitted the common stock of the plaintiff is owned by the Gas Service Company; that the capital stock of the Gas Service Company is owned by the Cities Service Company, and that the Cities Service Gas Company collects gas from its fields in Texas and Oklahoma and transports it to other states, including Kansas, selling it to its local distributing companies in said states, including the plaintiff. The common stock of the Cities Service Gas Company is owned by the Empire Gas & Fuel Company, and control of the capital stock of the Empire Gas & Fuel Company is owned by the Cities Service Company. Furthermore, this corporate set-up is controlled, or at least managed, by Henry L. Doherty Company of New York.

The defendant commission in passing upon the application for an increase in the local rate in Eldorado is entitled to, and in fact must, inquire the price that plaintiff pays for its supply at the city gate. This is an important item of plaintiff's cost, and before it is entitled to an increase based on the 40-cent rate, it must justify it like any other item of expense that goes to make up its total cost of doing business.

[fol. 62] The commission sought to elicit information and facts concerning the reasonableness of this 40-cent rate.

The plaintiff declined to make any showing as to the cost of gas to the Cities Service Gas Company at Eldorado, or as to the reasonableness of this charge, insisting, however, that the commission allow it as a proper item in fixing its new rate. Whereupon the defendant dismissed the proceeding.

The plaintiff's position is, as I understand it, that this so-called 40-cent rate is not a subject of inquiry by the Public Service Commission of Kansas. First, because this 40-cent rate was in the past approved in certain litigation affecting other towns not including Eldorado and, secondly, the parent company, Cities Service Gas Company, being engaged in interstate commerce, its charges are not subject to regulation by the local commission.

Admittedly, the local body has no control over interstate rates as such. It is to be observed, however, that the parent company is not a party to this proceeding, either here or before the commission, and cannot be affected by any action taken herein. The plaintiff, however, is asking the Public Service Commission to base its local rate on the 40-

cent wholesale rate. Therefore the defendant must require it to justify it and determine, as a fact in a proper proceeding, whether it is reasonable under all the conditions of the particular situation presented in Eldorado. To hold that the commission has no control over this item of plaintiff's rate structure would, in effect, nullify any regulation.

The plaintiff really relies upon the commerce clause of the Federal Constitution in refusing to offer any evidence on this question. It claims that the commerce clause, as stated in Grubb v. Public Utility Commission, 281 U. S. 470 at 475:

"as in some way operating to commit to the federal courts and to withhold from the state courts jurisdiction of all suits relating to the regulation or attempted regulation of interstate commerce. This view of that clause is quite inadmissible. It has no support in any quarter, is at variance with the actual practice in this class of litigation" (citing cases).

[fol. 63] Page 476:

"and is in conflict with the doctrine often sustained by this Court that the state and federal courts have concurrent jurisdiction of suits of a civil nature arising under the Constitution and laws of the United States, save in exceptional instances where the jurisdiction has been restricted by Congress to the federal courts."

This statement of the Supreme Court, while not directly in point, is interesting in view of plaintiff's position. See also East Ohio Gas Co. v. Tax Commission of Ohio, U. S. S., May 18, 1931.

It is not our duty to prescribe in advance the extent and character of the inquiry that the commission should make in respect to this 40-cent rate. That, in the first instance, is upon the commission. However, the plaintiff must try the issue there, and after it has made a proper showing that the commission has made its findings, then can it appeal to the Federal court—if it feels the commission has denied or violated some right, privilege or immunity guaranteed it by the Federal Constitution.

We may observe in passing—in view of the corporate set-up disclosed—that the relations of these companies are

such as to justify a close scrutiny of the whole situation. If it is disclosed that one group or holding company is, through its subsidiaries, collecting gas, transporting it in interstate commerce, and distributing it locally, the question of how many profits may be charged along the route between the gas well and the ultimate consumer may become material.

Furthermore, if plaintiff voluntarily, or under compulsion, pays the 40-cent rate for its gas, irrespective of its reasonableness, that may be the cause, and not the local rate, for its failure to earn a fair return on its investment.

July 3, 1931.

[fol. 64] IN UNITED STATES DISTRICT COURT

OPINION BY JUDGE HOPKINS—Filed June 26, 1931

HOPKINS, District Judge:

The plaintiff seeks to enjoin the defendant from enforcing the rate now on file for gas in the city of Eldorado, or from interfering with plaintiff putting into effect a new rate. The defendants by their answer have challenged the right of plaintiff to secure relief in a court of equity on the ground that such action is premature, contending that plaintiff has failed to exhaust its remedy before it, the Public Service Commission. The defendants base their contention upon plaintiff's alleged failure to exhaust its remedy before it because of its failure and refusal to produce evidence of the cost of service and rate of return by holding or affiliated companies.

The facts are substantially these: the plaintiff the Western Distributing Company is a Virginia corporation, doing business in the city of Eldorado. Its capital stock is owned by the Gas Service Company, a holding company which also owns stock and operates other public utilities in Kansas, Missouri, and Oklahoma. The capital stock of the Gas Service Company is owned by the Cities Service Company, a corporation holding the capital stock of several hundred public utilities throughout the United States. The capital stock of the Cities Service Gas Company is owned by the Empire Gas and Fuel Company. Henry L. Doherty,

doing business as Henry L. Doherty and Company, through agency contracts, manages and controls the operations of all these companies, both in their relations to the public and between themselves. The Gas Service Company above mentioned, operates and manages the plaintiff the Western Distributing Company, and keeps the books of the Western Distributing Company in Kansas City, Missouri. The plaintiff the Western Distributing Company procures or buys its supply of natural gas from the Cities Service Gas Company.

[fol. 65] It is admitted by the defendant that the plaintiff offered sufficient evidence to make a prima-facie case upon all issues before it except for the allowance of three charges, which are specifically mentioned in the findings. These items covering one and three-fourths per cent of the gross revenue of the plaintiff, which is paid to Henry L. Doherty and Company, certain expenses paid by the plaintiff to the Gas Service Company, and the principal item of $176,260 paid by plaintiff for gas to its affiliated company the Cities Service Gas Company at the gates of the city. It appears that the plaintiff declined to produce before the commission any evidence showing or tending to show the cost of these items and from a fair reading of the record I understand that the Western Distributing Company, which owns the stock of the plaintiff company through its officers, and employees, who are also officers and employees of the Gas Service Company, had in its possession and control, books and records and other evidence showing the kind and amount of expenditures of the Gas Service Company, but failed to produce such evidence and also declined to permit the defendant to examine its books.

Under these facts and circumstances, is the plaintiff entitled to the equitable relief which it seeks in this court?

A public service commission such as the defendant is a rate-making body. In order that it may find and establish a legal rate it must have sufficient evidence upon which the same must be based. In my opinion it is the duty of a complaining utility such as the plaintiff to furnish sufficient evidence that the public utilities commission will have a basis upon which to make a reasonable rate. I think the question as to whether a public utility must exhaust its remedy before the commission before applying for judicial

or injunctive relief is well settled. The legislature has within constitutional restrictions the power to place reasonable regulations upon public utilities and the courts will [fol. 66] not interfere with legislative regulation until it has been abused. Nor can the alleged abuse be anticipated.

[Chicago, Burlington & Quincy R. Co. v. Winnett, 162 Fed. 242; Backus-Brooks Co. v. Northern Pacific Ry. Co., 21 F. (2d) 4, Syl. 17.] Vincennes Water Supply Co. v. Public Service Commission, 34 F. (2d) 5.] [Cer. denied, 280 U. S. 562, 72 L. Ed. 427.]; Oregon Short Line R. Co. v. Teton Coal Co., 35 F. (2d) 919, Syl. 9.]; Henderson Water Co. v. Corporation Commission, 269 U. S. 277, 70 L. Ed. 273; Lawrence v. St. Louis-San Francisco Railway Co., 274 U. S. 588, 71 L. Ed. 1219; St. Louis-San Francisco Ry. Co. v. Alabama Public Service Commission, 279 U. S. 843, 73 L. Ed. 560; Simpson v. Shepard, 230 U. S. 352, 419, 57 L. 1511, 1550.]

The plaintiff argues that it was not required to produce all of its evidence before the public utilities commission, and strenuously argues that the principles enunciated in Smith v. Illinois Bell Telephan Company, — U. S. —, 75 Law Ed. 99, do not apply. With this contention I can not agree. It may be that the affiliated or holding companies, in this case, are making only a fair and reasonable charge for the service rendered by them or the commodity furnished. On the other hand if the facts are ascertained it might appear that the affiliated or holding companies are being unjustly enriched by charges made on the subsidiary company. If a holding company were permitted to exact from a subsidiary company an excessive charge for service or commodity without a public service commission taking such charges into account in determining the proper rate, it would destroy any attempt of the public service commission at regulation. It is argued that the matter comes before this court upon a trial de novo, and that the plaintiff may offer here the evidence it declined to offer before the public service commission.

We know of course that the matter comes before this court as a trial de novo, but such a trial would not give this court an opportunity to make a rate. This court is em-

powered only to set aside a rate made by a public service commission in a case of this kind, if such rate is unreasonable or confiscatory. The duty of this court is to refuse to grant relief asked by the complaining utility unless it [fol. 67] appears that the rate established by the public service commission is unreasonable or confiscatory.

A public utility must first exhaust its remedy before the public service commission before seeking injunctive relief against the commission.

The cost of services rendered, the cost of commodities furnished and rate of return earned by a holding or affiliated company is a material issue to be determined in a rate case, and at least a reasonably complete disclosure to the public service commission in respect thereto is necessary to enable findings to be made as to the reasonableness of payments made to an affiliated company for such services or commodities.

A public utility has not exhausted its remedy before the public service commission until it has produced evidence upon which findings can be made upon all material issues affecting the rate.

It is not proper for a public utility to withhold part of its evidence from the public service commission and first adduce it in Federal court in proceedings to enjoin the commission from interfering with the establishment of a new rate.

It is my view therefore, the Western Distributing Company having failed to exhaust its remedy before the public service commission is without standing to ask for relief in the courts and its amended bill of complaint herein should be dismissed.

[fol. 68] IN UNITED STATES DISTRICT COURT

PETITION FOR APPEAL—Filed July 18, 1931

To the Honorable J. Foster Symes, Judge of the said District Court:

The Western Distributing Company, your petitioner, who is the plaintiff in the above entitled cause, conceiving itself to be aggrieved by the decree entered in the above cause on the 26th day of June, 1931, for the reasons speci-

fied in the assignment of errors which is filed herewith, prays that it may be permitted to take an appeal therefrom to the Supreme Court of the United States at Washington.

Your petitioner further prays that appropriate citations be issued to each of said defendants, unless waiver of issuance and service be filed and that said decree be reversed.

And your petitioner desires that said appeal shall operate as a supersedeas and therefore prays that an order be made, fixing the amount of security which said plaintiff shall give and furnish upon said appeal, and that upon giving such security all further proceedings in this court be suspended and stayed until the determination of said appeal by the Supreme Court.

Dated July 18, 1931.

Robert D. Garver, Robert Stone, Attorneys for Plaintiff.

IN UNITED STATES DISTRICT COURT

ORDER ALLOWING APPEAL—Filed July 23, 1931

The above petition of the plaintiff in said cause for an appeal from the order and decree referred to herein is hereby granted, and the appeal is allowed, and upon petitioner filing a bond in the sum of $1000.00, with sufficient security and conditioned as required by law, the same shall operate as a supersedeas of the decree made and entered [fol. 69] in the above cause, and shall suspend and stay all further proceedings in this court until the determination of said appeal by the Supreme Court.

Dated July 23rd, 1931.

J. Foster Symes, Judge.

IN UNITED STATES DISTRICT COURT

ASSIGNMENT OF ERRORS—Filed July 18, 1931

Comes now the said The Western Distributing Company, plaintiff in the above entitled cause, and files the following assignment of errors, upon which it will rely upon [illegible]

prosecution of the appeal herewith petitioned for in said cause from the decree of this court entered on the 26th day of June, 1931.

I

The court erred in denying the application of the plaintiff for a preliminary injunction.

II

The court erred in the dismissal of plaintiff's bill of complaint and of said cause.

III

The court erred in holding that the plaintiff recover nothing under its bill of complaint and that judgment be entered in favor of the defendants herein.

IV

The court erred in refusing to make the findings of fact requested by the plaintiff (VII-A) as follows:

"The reasonableness of this rate was found and adjudicated by the Supreme Court of Kansas as to the City of Wichita, Kansas, in the case of City of Wichita v. Public Service Commission, said decision being reported in 126 Kansas 220; — Pacific —, and by this court in case numbered 1171-N, in Equity, final decree of which was entered in September, 1930. It is admitted by the pleadings that in this last mentioned proceeding, evidence was introduced showing that in November, 1928, the reasonable value of [fols. 70 & 71] the system of the Cities Service Gas Company was more than $83,000,000.00 and that the rate of 40 cents per thousand cubic feet for gas sold for domestic purposes to the several distributing companies served by the pipeline system would make a return to the pipeline company of less than eight per cent (8%) on such valuation."

V

The court erred in its conclusion of law that the plaintiff had failed to exhaust its administrative remedy before the Commission.

VI

The court erred in its conclusion of law that the complaint should be dismissed at the cost of the plaintiff.

Wherefore plaintiff prays that the said judgment may be reversed and for such other and further relief as to the court may seem just and proper.

Dated July 18, 1931.

Robert D. Garver, Robert Stone, Attorneys for Plaintiff.

Bond on appeal for $1,000, approved and filed July 24, 1931, omitted in printing.

[fol. 72] In United States District Court

Condensed Statement of Evidence Essential to Decision of Questions Presented on Appeal—Filed Aug. 17, 1931

It was stipulated by the parties hereto that—

On July 29, 1929, the Western Distributing Company filed its application with the Public Service Commission of the state of Kansas for increase in rates charged for natural gas in twenty-two cities and towns, including Eldorado, Kansas. The company in its application requested installation of the three-part rate which is based on the percentage of earnings of the distributing companies rather than on a fixed price at the city gate. The applications were set for hearing but continued from time to time on the request of the applicant to enable the engineers to prepare inventories and appraisals. On January 7, 1931, the applications were again set for hearing and counsel for the applicant stated it was prepared only on the Eldorado case at that time. Hearings on the Eldorado application were heard on January 7, 8 and 21. The evidence of the applicant disclosed:

1. The applicant, the Western Distributing Company, is a corporation engaged in the business of a public utility

furnishing natural gas to consumers in the city of Eldorado, Kansas.

2. Its capital stock is owned by the Gas Service Com- [fol. 73] pany, a corporation, a holding company owning, through stock ownership, and operating many public utilities in Kansas, Missouri and Oklahoma.

3. The capital stock of the Gas Service Company is owned by the Cities Service Company, a corporation, holding the capital stock of several hundred public utilities throughout the United States.

4. The capital stock of the Cities Service Gas Company is owned by the Empire Gas and Fuel Company, a corporation.

5. The capital stock of the Empire Gas and Fuel Company is owned by the Cities Service Company.

6. The Cities Service Company is the common owner of the companies recited above.

7. Henry L. Doherty, doing business as Henry L. Doherty & Company, through agency contracts, manages and controls the operations of all these companies, both in their relations with the public and between themselves.

The evidence also disclosed that:-

1. The Western Distributing Company pays 1¾ per cent of its gross revenue to Henry L. Doherty & Company. This payment in the amount of $3,454.43 was included in the items of expense for the Eldorado plant.

2. The Gas Service Company operates and manages the Western Distributing Company and keeps the books of the Western Distributing Company in Kansas City, Missouri, and charges to the Western Distributing Company certain sums annually purporting to be the Western Distributing Company's share of expense of the Gas Service Company. These charges, amounting to $5,970.11, were included in the items of expense for the Eldorado plant, also unclassified expense amounting to $4,667.91, which was reimbursement for specific services rendered.

3. The Western Distributing Company buys its supply of natural gas from the Cities Service Gas Company.

There was included in the items of expense for the Eldorado plant the sum of $176,260.32 paid to the Cities Service Gas Company for gas purchased.

The sufficiency of the applicant's evidence to make a prima case upon all issues except the three mentioned above is admitted.

[fol. 74] With reference to the three items above enumerated, the following testimony was introduced before the Commission.

The first witness was Mr. Fred H. Rice, Engineer for the Gas Service Company, who testified in substance as follows:

The expense item of 1¾ per cent of the gross revenue paid by the applicant to Henry L. Doherty & Company in New York is the same as is paid by all other properties in the Cities Service group, not only in Kansas but in the United States, and does not in any respect differ at this time from what it was when the propriety of the charge was adjudicated by the Supreme Court of Kansas in the Wichita rate case, and the federal court for the first district of Kansas in the Wichita rate case. The item of expenses for administrative expenses for general supervision of the Kansas City office is also the same as when the propriety of that matter was adjudicated by the Supreme Court of Kansas and the federal court, above referred to, in the Wichita case, except that the amount may be lower, due to the addition of new property. The system or method of allocation is the same.

The decision of the Supreme Court of Kansas in the Wichita case, and the decision of the federal court in the Wichita case as an adjudication of the propriety of those charges, were offered and objected to as not binding upon the Commission. The objection was sustained but the Commission announced: "The Commission will take notice of these decisions."

Witness continuing testified there is no other source of supply at Eldorado than the gas furnished by the Cities Service Gas Company, and no other gas was ever offered for distribution at a cheaper rate than that being paid, within my knowledge. The cost of gas to the Western Distributing Company at the city gate at Eldorado is 40¢ per thousand cubic feet for the domestic gas, which is

purchased from the main line of the Cities Service Gas Company, which is the pipe line or transportation company. That company and the distributing companies are subsidiaries of the Cities Service group.

No other supply of gas has been offered. If any were offered, the distributing company would buy it. The rates [fol. 75] at the city gate are determined by the cost of operation and cost of securing gas and cost of investment and transportation to the pipe-line company. I do not think that the expense of getting to the gas and bringing it to the market is altered a great deal, but I am not qualified to answer on the pipe line cost, but in my opinion, it costs just about as much as it did fifteen or sixteen years ago. Eldorado buys all its gas from the same company and for the ten years last past, the price has been the same.

The 1¾ per cent paid to Henry L. Doherty & Company is fixed by him and agreed to by the directors of the Western Distributing Company in a written proposal. I am unable to answer specific questions as to the service rendered under the paragraphs of the proposal which was submitted to the commission. Henry L. Doherty & Company, under this contract, furnish general engineering services off and on, but I cannot give any details and have never made any specific investigation. The records would probably disclose what services have been rendered.

Under the paragraph reciting "the securities department will provide plans for the sale and distributing of various securities and will furnish and carry out campaigns for sales under customer ownership plan, and so forth," the Western Distributing Company would derive the same benefits that any of the rest of the companies would.

I do not know that the Western Distributing Company has sold any stock during the period mentioned. I do not know what engineering services were specifically rendered under the contract or proposal.

A certain portion of the expenses of the Gas Service Company is charged to the Western Distributing Company. This varies. The expense of the Gas Service Company is allocated to the different distribution companies on a basis of gross revenue; some of the departmental expenses, however, are allocated on a meter basis.

[fol. 76] For the period under investigation, the expense amounts to $5,970.11 not including unclassified additional expense of $4,667.91 for specific services rendered in the appraisement of the Eldorado distributing plant. Services consisted of all administrative and executive service, financial aid and advice, general purchasing and warehousing operations, all of which were handled by the Gas Service Company. I am reading from what they actually do handle; all general engineering and operating supervision, all legal services, all insurance purchases, all general accounting is done by the Gas Service Company, all reports of all kinds are made by the Gas Service Company; they have supervision and handling of all tax matters, handle all pay rolls; they make all audits and audit reports."

Mr. Fred H. Rice was recalled and testified, in substance, as follows:

"I am not connected in any manner with the pipe line company, but was present during the trial of the Wichita case in the federal court, above referred to. In that case, the chief engineer or head of the rate department of Henry L. Doherty & Company, from the New York office, testified to the valuation of the property of the pipeline company. There was offered in that case the operating reports from the Bartlesville office, which they had made to the New York office, for the two year period. These reports contained all the information that goes from the operating offices to the parent office. On the valuation testified to by the chief engineer and on those reports, it appeared that the 40¢ city gate rate was reasonable. What the witness heard in that case is all the information he had in regard to pipe line matters."

In response to an inquiry by Mr. Montgomery, then a member of the Commission, it was stated that the only valuation introduced was a general estimate by Mr. Hamilton, chief engineer of Henry L. Doherty & Company, which was a general estimate in round figures. No exhibit was introduced, but his testimony occupied a day or two. It [fol. 77] was stated by counsel for the applicant that no valuation, to his knowledge, had been made of the pipe line

system; that he had been informed that it would cost $50,000.00 to $100,000.00 to make it.

On cross examination, Mr. Fred W. Rice stated he had no facts on the cost at the city gate, but presumed that the Cities Service Gas Company had those facts which, however, were not available to him:

"Q. But Henry L. Doherty & Company controls that company?

A. Yes, sir.

Q. It would be possible for you to get the figures would it?

A. Yes, sir.

Q. As a matter of fact the rate at the city limits of every city served by your company is just the same, isn't it —?

A. Approximately the same; yes."

Some discussion followed, in which it appeared that the 40¢ gate rate was established by the Kansas Commission and then was repealed on October 20, 1924.

Mr. Rice further testified:

I have never made any study of the expenses of the Gas Service Company or of the Henry L. Doherty Company on the charges above referred to, nor of the cost to the pipe line company to produce or buy and deliver gas to the Western Distributing Company, and would have no means of making such a study.

Commissioner Montgomery then called attention of the parties to a part of the decision of the U. S. Supreme Court handed down December 1, 1930, in the Illinois Bell case, which reads as follows:

"The point of the appellant's contention is that the Western Electric Company, through the organization and control of the American Company, occupied a special position with particular advantages in relation to the manufacture and sale of equipment to the licensees of the Bell system, including the Illinois company; that is, that it was virtually the manufacturing department for that system, and

the question is as to the net earnings of the Western Electric Company in that department and to the extent to which, if at all, such profit figures in the estimates upon which the charge of confiscation is predicated.
[fol. 78] We think there should be findings upon this point."

Mr. Montgomery then continued:

"That is, as I understand it, the supreme court remanded this case for findings as to what it cost the Western Electric Company to produce the material which it sold to the Bell company. I wondered if you had given that consideration."

"Mr. Garver: Our position in regard to that is, we made a full disclosure of all that in the Wichita case; we have introduced evidence, there has been no change in the situation, the court found the charge was reasonable. That is an adjudication of that issue."

"Commissioner Montgomery: I asked you if the cost to Henry L. Doherty was one and three-fourths per cent. Now, the supreme court in this case said: 'In view of the findings, both of the state commissions and of the courts, we see no reason to doubt that valuable services were rendered by the American Company, * * *' That is, the service rendered under the A. T. & T. contract, with which we are all familiar, 'but there should be specific findings by the statutory court with regard to the cost of these services to the American company and the reasonable amount which should be allocated in this respect to the operating expenses of the intrastate business of the Illinois Company in the years covered by the decree.' You have not prepared any statement along that line?"

A. "No, sir."

Mr. B. C. Adams, vice president and general Manager of the Gas Service Company and president of the Western Distributing Company, testified:

The Gas Service Company from its Kansas City office has a supervisory management of all of the natural gas distribution properties in the Cities Service group in Kansas, Oklahoma and Missouri, and is the owner of the stock

of the Western Distributing Company. The stock of Gas Service Company is owned by Cities Service. The towns all receive their supply from the Cities Service Gas Company. The manager of the Eldorado property reports to the Gas Service Company at Kansas City and I report to my immediate superior, Judge Caster, of Henry L. Doherty & Company. I am familiar with the functions of [fol. 79] the Kansas City office, which in my opinion renders services to the Eldorado company which are of the value that company pays for them. The Eldorado company could not be run as a separate and distinct company without any connection with the forces of the Cities Service organization and produce the same results in the way of providing customers with gas and with service any more economically than it is now run. The method of doing business is proper and the local company gets value received for it. The operations of the Kansas City office are reported to the New York office, to which it is responsible and any unnecessary employes or unnecessary expenses would subject the Kansas City office to being called to account, which results in an endeavor to render the best service at a- cheap a price as possible.

I am familiar with the 1¾ per cent paid to Henry L. Doherty & Company for services rendered its proposal, and, in my opinion, those services are worth the price that is paid for them by the applicant and other companies, and the arrangement is a proper business one. If I did not think it was a proper one, I would complain about it. The same per cent is paid by all of the properties all over the United States.

The same price, 40¢ for domestic gas at the city gates, is paid to the Cities Service Gas Company at Kansas City, Topeka, and all other towns where local gas does not enter into the situation. There is no other gas supply in the vicinity of Eldorado. No other or cheaper gas has been tendered to the company by any one. Wherever local gas is available, it is the policy of the companies which are operated by the Gas Service Company to purchase such local gas. This is done in several towns, such as Cherryvale and Parsons, and if there was any local gas available at Eldorado, it would be purchased."

[fol. 80] On cross examination, Mr. Adams further testified:

The Western Distributing Company has made efforts to find local gas near Wichita, but there isn't any. The 40¢ rate for domestic consumers at the city gates is fixed by the Cities Service Gas Company and is paid by the local distributing companies without argument. With respect to the reasonableness of this rate, I have heard the testimony of Mr. Hamilton, in the Wichita case, and from time to time from the officers of Cities Service Gas Company, officers of Henry L. Doherty & Company, and officers of Cities Service Company, something about what the earnings of the Cities Service Gas Company aggregate, and from what I have heard as to their investment and return on that investment, they are not earning a fair amount for return and depreciation. My knowledge comes from the report submitted in the Wichita case and the testimony of Mr. Hamilton and what I am told about the earnings of the company and its investments.

I do not recall the average cost of gas, but do recall the valuation submitted by Mr. Hamilton and the net earnings applicable to depreciation and return. There was some testimony covering the cost of delivering gas, exclusive of all overhead.

My theory about the price that the distributing company pays for gas is this: We are less interested in the price we pay for gas than we are in the ability of the company to deliver us gas at all times during the peak loan and during the loads that are less than those loads during peak hours. I think this is a major factor, providing a rate is not so high that we cannot dispose of our gas in competition with other fuels for domestic purposes and building heating and industrial purposes. I have heard that the 40¢ rate was fixed at the time there was some question in the minds of a great many utilities men whether there was an available gas supply and that the rate was fixed at 40¢ in order to en-

[fol. 81] courage the pipe line companies to make expenditures of moneys that would bring to the city gates of the towns served a sufficient amount of gas to provide the requirements of domestic users.

Commissioner Montgomery asked whether the books of the Gas Service Company were available for the examination of the Commission, to which Mr. Garver replied:

"They are not and the courts have held it was not necessary for the Commission to have them."

Commissioner Montgomery: I am asking Mr. Adams as president of the Western Distributing Company whether he is willing to make a full and complete disclosure by making available to the Commission the books and records of the financial transactions of the company.

A. There is a legal question about that and I would be guided by the advice of attorneys.

Commissioner Montgomery: Are you willing to submit those records to the Commission now?

A. I will submit the request to the attorneys and be guided by their answer.

Mr. Garver: The attorneys will tell you now—no.

Mr. Hatcher: You don't know whether the charges are unreasonable or not or what the services are worth?

A. I think they are not unreasonable.

Mr. Hatcher: Do you have any opinion on which to base that?

A. Yes, I do.

Mr. Hatcher: Can you produce that information?

A. I have access to the books of the Gas Service Company.

Mr. Hatcher: Now as to the Western Distributing Company which you contend is the only party you are representing and refuse to bring in those books, but as an officer of the Western Distributing Company you do not know what, or have information as to what, services you pay for or whether or not those services are reasonable, do you?

A. Yes, sir.

Mr. Hatcher: Will you produce that information?

A. I will be guided by the advice of attorneys.

Mr. Garver: You testified, too, in regard to the forty cent gate rate being established in 1923. At the time that rate was established were these different distributing companies owned by the Cities Service Group—not the Western Distributing Company, but a large majority of companies, Kansas City—the two Kansas Cities—Topeka, Wichita, Hutchinson, Newton, Pittsburg, and a great majority of them are owned now that were owned at the time that forty-cent rate was established?

A. They were not owned by the Cities Service Company or any subsidiaries of Cities Service Company or any in-

terest in Cities Service Company, even a partial interest in it.

[fol. 82] Commissioner Montgomery: At the time that rate was put into effect, didn't the independent distributing companies oppose that rate?

A. I think they did.

Commissioner Montgomery: And you say that the Cities Service Company did not at that time own any of the distributing companies—but it did at that time own the pipe line company.

A. Yes.

Mr. Garver: So at the time that rate was established there may have been—there could have been—no collusion between the pipe line company and the distributing company?

A. No.

Mr. Garver: As a matter of fact were not most of the distributing companies at that time antagonistic to the pipe line companies and in constant litigation?

A. They were.

Mr. Garver: Particularly the Kansas City Gas Company?

A. Yes.

Mr. Garver: Since these companies have been purchased by the Cities Service group has there been any change in that city gate rate?

A. There has not.

Commissioner Montgomery: Has there been any antagonism on the part of the distributing companies to that rate?

A. Well, as I have said previously to in my testimony, I think that the thing the distributing companies should be interested in most is ability to get gas when the customers, particularly the domestic customers, need it.

Commissioner Montgomery: My question was when the distributing companies were independently owned they opposed the forty-cent gate rate?

A. Yes, sir.

Commissioner Montgomery: Since the distributing companies have been acquired by the Cities Service Company have they opposed the forty-cent gate rate?

A. There has been no litigation, because I understand it was adjudicated at the time of the purchase.

Commissioner Montgomery: As I say, my question was if the distributing companies opposed the forty-cent gate rate since they have been owned by the Cities Service Companies.

A. They have brought about no litigation.

Commissioner Montgomery: Have they opposed it?

A. I don't know what you mean. That is what I am trying to answer. I say the distributing companies have the duty of buying gas as cheaply as they can buy it, they must take into account when they buy it that the source of supply will give them the gas they require for their customers at all times, because a distributing system without gas in it has no value. A distributing system without gas in it has no value. A distributing system without gas in it destroys the investment of every customer who has bought a gas range or a gas water heater or a gas furnace installation; unless he can get gas to use in those appliances there is no value in them."

On recross-examination, Mr. Adams stated:

[fol. 83] I have testified that the distributing company at Eldorado was receiving valuable services for the money expended to the Doherty Company and the Cities Service Company. That was my judgment. Under advice of counsel, I have refused access to the books to determine actual expenditures made by the company in performing these services. The 40¢ rate at the city gate was determined in 1923 t- be reasonable. There has been a change in conditions that may make the rate unreasonably low. I have discussed the 40¢ rate with the Cities Service Gas Company, trying to get a lower rate. This was discussed with the officials of the Empire Gas & Fuel Company, also, who control the Cities Service Gas Company. I have not been able to get any lower rate.

The rate necessary to domestic use depends upon the city gate rate.

There has not been any change in the manner of charging the New York 1¾% or the matter of services rendered, since the decision by the Kansas Supreme Court and the U. S. District Court. Each of these items was approved by each of those courts. While more properties are now owned than were owned when the question was

Electric Company on its total business had not been 'In excess of seven per cent and never above ten per cent.'

"Mr. Adams, in his testimony, stated to this Commission that he did not know, and did not claim to know what the profits or earnings were of the Cities Service Gas Company, because that is a company of which he had no knowledge or control, and was not furnished with that information."

(Continues reading from the decision.)

[fol. 86] "In other words, the Supreme Court has directed the lower court to make findings as I have read to you.

"There is absolutely nothing in this evidence upon which you can predicate an order that the gas at the city gate is fair and reasonable, and there is no evidence at all showing any cost of that service to the Western Distributing Company, which the Supreme Court has directed the lower court to ascertain in the Illinois Bell Telephone case.

"Now, I picked up a little magazine published by the General Utilities Association. I think it is a very fair magazine. On the front page of it, it says this:

(He then reads from the magazine.)

"That, up until this Illinois decision was the law of the land affecting public utility rate questions. Now, here is what they say:

"'But in this latest case, the court, holding that the companies were all parts of one integrated system, recognizes a new element. It holds that the cost of rendering the service, or of manufacturing the article, by the parent or affiliated company, is a factor which must have consideration.'

"And there is no evidence, if the Commission please, in this proceeding at all, as to the cost of the services rendered by the Doherty Company nor the cost of the services rendered by the Gas Service Company or the reasonableness or justness of any cost which they may make. Now, in conclusion, this article concludes:

"It is readily seen that the distinction between the two tests is a real one, and that it may have far-reaching con-

sequences in its application to similar corporate relationships."

"So, therefore, for the reasons stated, and without reiteration, I move, and on behalf of your legal department, Mr. Hatcher and I are in entire accord in our procedure, move that the application of the Western Distributing Company for an increase in rates to the gas consumers in the City of Eldorado be denied.

[fol. 87] Mr. Garver: "If the Commission please, I am familiar with the decision of the Supreme Court of the United States in the Illinois case. I do not think it has any application, and I do not intend to argue it. It is immaterial whether it is applicable or whether it is not.

"What this motion means and what the ruling by the Commission would mean, if it should hold that in each rate case we have got to put in a valuation and a financial exhibit for the pipeline company and prove the reasonableness of a 40¢ city gate rate there could not be any such thing as a rate case. Take these twenty-two little towns, some of them have not got a hundred meters in them. It would cost a hundred thousand dollars to make a valuation of the pipeline system and a whole lot more to get auditors to audit its books. It makes it absolutely impossible. Take the situation in Lawrence, Leavenworth, Atchison. Suppose we would bring a rate case before the Commission; we are paying the Cities Service Company, with which we have no connection whatever, 40¢ at the city gate. The Commission would have to say the investigation started with that 40¢ because those companies have no relationship whatever with the Cities Service group and could make no possible showing as to the situation in regard to these companies now under investigation and can be no different than those." (Tr. 328-340 inc.)

Commissioner Montgomery: "Wouldn't that apply to the telephone company that had small exchanges that paid a certain sum, if that rule is applicable?"

Mr. Garver: "Well, I don't think the rule is applicable because your telephone companies are engaged in interstate business. They have their interstate calls as well as the local calls." (Tr. 341.)

Commissioner Montgomery: "In speaking of the determination of the 40¢ rate in the case before Judge McDer-

mott, I do not believe the 40¢ rate was determined under [fol. 88] that case. As I recall it, the operating reports which you referred to which contain very little information except in round figures and in large sums, there was no valuation introduced, no appraisal of the property, no apportionment of the value of the property as between respective uses, and I do not believe that that matter was submitted in that case at all."

Mr. Bond: "I was assuming Judge Garver's statement was correct."

Mr. Garver: "Here is what the decision says:

'The plaintiff in fact pays 40¢ for its gas. There is no suggestion in the record of collusion or fraud. The evidence shows the rate to be reasonable, under similar circumstances. The rate has been approved by the State courts and I find no reason for sustaining the exception leveled at that rate.' That ought to end it." (Tr. 344.)

Commissioner Montgomery: "We will take a ten-minute recess."

(Intermission.)

Commissioner Montgomery: "The Commission is of the opinion that, in view of the rules laid down by the Supreme Court in the Illinois Bell case, that the motion should be granted and it is granted. The application is denied."

Mr. Garver: "I want to make another offer in this pending case. The Western Distributing Company moved that the case be reopened and that it be permitted to introduce the complete transcript of the record in the Federal Court in the case of the Wichita Gas Company against the Public Service Commission, and particularly the testimony of F. C. Hamilton in regard to the pipeline valuation and financial experience, Mr. Hamilton being outside the jurisdiction of the court and not *busject* to its subpœna. We offer that record in evidence."

Mr. Steiger: "May it please the Commission, unfortunately neither Mr. Hatcher nor myself are familiar with [fol. 89] that testimony. Speaking for myself, and I think also for the other gentlemen, we would certainly like an opportunity to read that testimony before asking the Commission to pass on that motion of Mr. Gaver's at this time."

Commissioner Montgomery: "What particular parts of the testimony do you have in mind?"

Mr. Garver: "All of the testimony of F. C. Hamilton showing the pipeline valuation and financial experience."

Mr. Hatcher: "What year did that cover?"

Mr. Garver: "I think 1927, 1928 and 1929, is my recollection of it. I do not recall."

Mr. Hatcher: "Are you willing to make the statement here that the evidence as produced there as to valuation and earnings is the same at the present time?"

Mr. Garver: "No."

Mr. Hatcher: "Will it have any application to this case? The testimony so far is that the situation is not materially different."

Commissioner Montgomery: "I would like to see that part of the testimony that you refer to in respect to valuation of the pipeline and showing as to income and expenses. It is my recollection that in that case there was no valuation; it was merely a rough estimate of something like $80,000,000 by Mr Hamilton, that was not based on any present cost to reproduce new less deterioration. There has been no appraisal, as he testified. The statements of income and expenses, as I say, were merely summaries of income and expenses in order to make a finding based on those statements of income and expenses. There would have to be available the records of the company so that the items constituting those expenses could be examined and presented to the Commission; and how long a time do you want, Mr. Steiger?

Mr. Garver: "Then this motion is overruled?"

[fol. 90] Commissioner Montgomery: "No, it is not overruled. How long a time, Mr. Steiger, do you want for examination of the testimony?"

Mr. Steiger: "Well, I would suggest ten days. Here is the thought that comes to me, if your Honor please. The attorneys, who appeared in this former proceeding which has been referred to and in which Mr. Hamilton testified, certainly examined him, if they examined him at all, as to the conditions existing at that particular time and as to the law applicable then. He could not have been examined or cross examined as to the law as laid down by Chief Justice Hughes in this present telephone case because it was not the law, did not exist, so therefore, if this testimony goes

to the extent that I infer from Mr. Garver that it does go, why I would, speaking for myself, object to the introduction of it on account of the fact that we do not have him here and cannot cross examine him in reference to the new rules which the Supreme Court of the United States has now said must be taken into consideration and which no doubt was not taken into consideration at the time of his appearance."

Commissioner Montgomery: "Is the Cities Service Gas Company building a line to Chicago?"

Mr. Garver: "No, sir, the Cities Service Gas Company, Standard Oil Company of New Jersey, Insull, Columbia, Phillips, Skelly and seven or eight of them."

Commissioner Montgomery: "We believe counsel should have an opportunity to examine the testimony with which he is not familiar, and we will continue the matter for"——

Mr. Garver: "I will withdraw the motion. I would rather get it started in the courts and find out what the law is now."

Commissioner Montgomery: "All right, then, the matter is adjourned."

During hearing counsel for Commission admitted for the purpose of the hearing only and on objection to admission of affidavits of O'Connor, Weymouth, Brown and Hancock that the territory served by pipeline company could not be segregated into separate zones for purpose of fixing different costs of gas at city gates in different zones.

[fol. 91] At the hearing before the statutory court herein, it was agreed and stipulated by the parties that the testimony which is summarized as above was offered to the Commission. In addition thereto, the plaintiff offered and the court received in evidence affidavits as follows:

[fol. 92] AFFIDAVIT OF THOS. R. WEYMOUTH

I reside at Round Hill Road, Greenwich, Connecticut. I am vice president of Columbia Gas & Electric Corporation. Since 1903, I have been identified with design, construction, and operation of natural gas production, transmission and distributing systems. I am familiar with natural gas pipeline systems of Columbia Gas & Electric Corporation, which has over 12,000 miles of transmission mains in operation

and over 17,000 miles of distribution and field lines in use in rendering natural gas service to more than 1,000,000 consumers in the States of West Virginia, Kentucky, Indiana, Ohio, Pennsylvania, Maryland and New York.

I have had charge of the engineering work on a number of natural gas pipe line systems. I was formerly president of the Iroquois Gas Corporation and president of the Oklahoma Natural Gas Corporation, and am familiar with all the major natural gas pipe line systems in the United States.

The development of a major gas transportation system is dependent upon the aggregate of the several distribution plants served by it so that such plants are inter-dependent in securing the service. If some of these were absent, the cost of making gas available to the remaining plants would be excessive. Consequently it is not only impracticable, but also inequitable to discriminate between communities on account of location, since location is only one of the many factors involved in determining a city gate rate.

The intermediate communities on the long pipe line to an important market would not have gas service at all, were it not for the existence of the large terminal market which, together with the intermediate market, is sufficient [fol. 93] to justify the investment in the line. Therefore, these intermediate communities should not have lower rates than the market which is responsible for their having gas service. For instance, the pipe line bringing gas from Texas to Kansas City, the principal market, is able to supply gas to municipalities en route solely because the large market at Kansas City has made it financially feasible to construct this utility; and but for that large market, the intervening communities would not be supplied natural gas. It is obviously unfair to give the intermediate communities lower rates than Kansas City, which has made the project possible, and which would thereby be compelled to pay a higher rate in order to produce the necessary revenue for the whole project. The only equitable and practicable basis of charge is a uniform city gate rate to all communities on the pipe line which automatically and properly allocates the cost of the service without regard to location.

Affidavit of Floyd C. Brown

I am vice president and general manager of the Continental Construction Corporation, which is engaged in the construction of a twenty-four inch gas transportation pipe line from the Amarillo Gas Field of Texas to Chicago, Illinois, and contemplate an expenditure of approximately $81,000,000.00 on this project. Associated in said project are Cities Service Company, Standard Oil Company of New Jersey, Insull Son & Company, Phillips Petroleum Company, Skelly Oil Company, The Texas Company and Columbia Carbon Company.

I am a graduate of Leland-Stanford University and ever since 1913, have been in close touch with the operation of natural gas fields and natural gas pipe lines and am familiar with all the practices of the industry in relation [fol. 94] thereto. I was employed by the Cities Service Gas Company for thirteen years, and am familiar with its gas transportation system, as well as other systems throughout the country. The experience of the industry has been that it is impossible to zone a major gas transportation system as to city gate rates, either with respect to the distance from the source of supply or with respect to the actual cost of gas delivered at any specified point; that the experience of the industry has conclusively demonstrated that in order to make such projects economically possible the system must be considered as one unit to be operated for the common benefit of all cities located thereon with like rates and charges as to each city similarly situated as to market conditions; that in practical consideration such transportation systems are not different from a city distribution system as to which the same rate is charged consumers notwithstanding the fact that some may be located within a few feet of the city gate while others may be many miles away and the actual expense of serving the latter many times greater than such expense as to the former. If an attempt were made to reduce the gate price to cities located near the source of supply according to the actual cost of service and increase same to cities further removed on the same basis, the cost to remote cities would be prohibitive in competition with other fuels and the resulting available market would not be sufficient to support the project.

I have had numerous conferences with the officers and engineers of all the companies concerned, at which was considered the matter of rates to be charged the various cities in the several states through which said line passes and it was the unanimous opinion of all concerned that the project was economically unsound if any system of zone rates was attempted and that such project was feasible only if considered as a unit for the equal benefit of all cities located thereon and with like rates to each city having similar market conditions without regard to the distance from the source of supply or the actual cost of service to the respective city gates.

[fol. 95] In the consideration of the Continental Construction Corporation project, the available market along the entire course of said pipe line from Texas to Illinois was first determined and a pipe line system then planned adequate to effeciently care for such market. There was then determined the price per thousand cubic feet which said system would be necessary to care for its necessary operation expenses and a proper amount for return, amortization, depreciation, and depletion. Such a schedule of rates has been determined and contracts have been and are now being entered into with distributing companies and cities located on or adjacent to said system, such schedule of rates being the same as to all such markets similarly situated as to market conditions; if the company should be required to revise its rates on the basis of cost at each city gate, the entire project would fail for the reason that in order to produce the required earning the cost of gas to remote cities would be so high as to be prohibitive, in competition with other fuels, and the aggregate market, upon which said project was based, would be so diminished as to make financial success impossible.

I am familiar with Cities Service Gas Company rates at the city gates of cities located thereon and the rates to be charged by the Continental Construction Corporation for cities located thereon are in excess of the rates being charged by the said Cities Service Gas Company, if computed on the same basis. If the major pipe line systems of the country, including that of the Cities Service Gas Company, should be compelled to revise their city gate rates on the basis of cost of service, the established principles of the

industry, developed from years of experience, would be entirely overthrown and the continuance of the operation of such systems would be rendered impossible.

[fol. 96] AFFIDAVIT OF H. D. HANCOCK

I reside in New York City, and am chief engineer of the Gas Division of Henry L. Doherty & Company. I am familiar with all natural gas pipe line systems, including the Cities Service Gas Company, in the Cities Service Company group of properties supplying 233 cities and communities in Kansas, Oklahoma, Missouri and Nebraska. I am a graduate engineer, having graduated from the University of Missouri in 1912 with the degree of Bachelor of Science. Since that time, I have devoted my entire time to work in connection with the transportation and distribution of natural and artificial gas, and am familiar with the practice of the industry in relation thereto.

In the absence of dissimilar market conditions or the availability of local gas, the gate rates of Cities Service Gas Company as to all cities in the four states which it serves are the same, being, with minor exceptions, 40¢ per thousand cubic feet for domestic purposes in Kansas, Missouri, and Nebraska, and thirty-five cents in Oklahoma, the business of the company in the latter state being intrastate.

The Colorado Interstate Gas Company, operating a transportation line from the Amarillo field to Denver, Pueblo, and other cities served, has a 40¢ city gate rate. I am informed and believe that 40¢ is the city gate rate of the Lone Star Gas Company at Dallas, Fort Worth, and other Texas cities on its pipe line system in Texas, and the rate of the Missouri Valley Gas Company for Lincoln, Nebraska, Council Bluffs, Iowa, and other cities in Nebraska and Iowa located on its line from Texas to Iowa is graduated on a volume basis from forty-five cents to thirty-seven and one-half cents and results in an average rate of at least forty cents.

The rates of major pipe line systems are comparable as to price under similar circumstances, and are all estab- [fol. 97] lished and maintained without attempt to zone

said systems on the basis of actual cost at the respective city gates, and without regard to nearness or remoteness from the source of supply. The experience of the industry has been that it is impossible to zone a major gas transportation system as to city gate rates, either with respect to distance from the source of supply or with respect to the actual cost of gas delivered at any specified point. Experience has conclusively demonstrated that in order to make such projects economically possible each system must be considered as one unit to be operated for the common benefit of all cities located thereon, with like rates and charges as to each city similarly situated as to market conditions. If an attempt were made to reduce the gate price to cities located near the source of supply according to the actual cost of service and increase same to cities farther removed on the same basis, the cost to remote cities would be prohibitive in competition with other fuels, and the resulting available market would not be sufficient to support the project.

If the major pipe line systems, including that of Cities Service Gas Company, should be compelled to revise their city gate rates on the basis of cost of service, the established principles of the industry, developed from years of experience, would be entirely overthrown and the continuance of the operation of such systems would be rendered impossible.

It would be impossible to determine the cost to any given pipe line system of gas at any given point for the reason that such system having been designed and built for the supply of an aggregate market composed of many cities far removed from the source of supply and from each other, and due to the fact that no one of said cities could support such pipe line or could enjoy the benefits of gas service standing alone and not considered in connection with the aggregate market, there could be no basis or rule of computation for the determination of the cost to such city if separated and considered apart from the aggregate market. [fol. 98] Cities Service Gas Company receives its supply of gas from sixty-three widely separated fields, all of which gas is commingled in its general system and made available to all markets thereon. It would be impossible to determine the original of gas reaching any particular market or the cost thereof at the city gate. Such sources of supply are

litigated, in the Kansas supreme court and the federal court, the manner and method of allocating the actual cost of the Gas Service Company to various properties has not been changed.

Lawrence, Leavenworth, and Atchison, and perhaps some other distributing companies, are still owned by outside interests and are paying the 40¢ city gate rate the same as properties which are owned by the Cities Service group.

[fol. 84] FRED H. RICE was recalled and identified exhibits dealing with valuation, revenue, new business expense, and operation of the three-part rate. The applicant then rested its case with the Commission.

STATEMENT AND MOTION

Whereupon Mr. Steiger, attorney for the Commission, made the following statement and motion:

"May it please the Commission, at this time the attorneys for the Commission desire to present a matter to the Commission which has never been presented in like manner in my experience with the Commission, or has it ever been presented in like form in the past, so far as my knowledge and experience goes.

"Very recently there was a very important decision handed down by our Supreme Court, and the Supreme Court, in speaking through its chief justice, has apparently, using the common everyday language, made a new law; that it departed to a great extent from their decisions and rulings heretofore made in rate matters. They have apparently taken into consideration other necessary facts which can be determined, and upon which there must be competent testimony to determine, into consideration. Now, that has never, in the history of our Supreme Court, been taken into consideration in prior proceedings, and just recently, in a Supreme Court decision handed down by, I think, Chief Justice Hughes—although I am not certain as to that—the advance sheets of which have not been published, but only generally speaking, the decision in the

Florida case, which I refer to from information at hand, is apparently of very far-reaching importance, just decided within the last three or four days; it is one which Mr. Benton communicated with us about. I mention it only as incidental to what I desire to take up and only for the purpose of stating that apparently the Supreme Court of the United States is getting back now more and more to the law applicable to state regulation, wherein it is possible for the state commissions to function.

[fol. 85] "I want to briefly read from the Illinois case; that is the case we are familiar with, to a certain extent. I will read from the syllabi first."

Mr. Garver: "I think you should make your motion and argue it afterwards, rather than make the argument in the motion."

Mr. Steiger: "Sometimes one lawyer does things differently from what some other would do, and you, perhaps, would go at it right, and make your motion first; I, perhaps, am going at it in the wrong way and making my statement first."

(Here Mr. Steiger read from the decision referred to.)

"And in this connection I want the Commission to keep in mind the same identical set-up of companies involved in the Illinois telephone litigation, such as parent company and subsidiary companies, has the same identical set-up in this case, except in the telephone case it is a matter of sale of telephone appliances and in this instant case it is the matter of selling gas, same interlocking system of subsidiary companies existing under both of these proceedings."

(Continues reading from the decision.)

"In other words, in the la-guage of Chief Justice Hughes, the State Commission, in determining the fair basis of rate in the Illinois case, did not take into consideration at all as to the fairness of the price purchased from the Western Electric Company upon the telephones used:

"On the record in this suit, the court concluded that the city had failed to support its contention that these prices were exorbitant. The court said that it appeared that for the past fourteen years the average profit of the Western

constantly changing, due to the exhaustion of some fields and the discovery of others. Of the 881 wells now connected to said system, few important wells have been so connected longer than five years, the experience outside of Texas being that the average life of a well is three years and the average life of a field five years. Any attempt to zone a system as to rates based either on cost or distance from supply would be impracticable on account of such constant fluctuations, even if practical in other respects.

The original project of Cities Service Gas Company was based on the market furnished at Kansas City, Missouri and Kansas City, Kansas, said cities being at the far terminus of said system and at the present time the market in said cities and in Missouri comprises almost one-half of the entire market of said pipe line system. Said system could not have been built and could not now be maintained without such market. While said market is farther removed from the source of supply than any other market on said system, the competition with other fuels is the keenest and the requirement of comparable rates most imperative. If said system should be zoned on a cost or distance basis, the rates in Kansas City and other Missouri towns would be of necessity so increased as to fall short of meeting competition, the market would be lost, and the operation of said system made impossible.

[Tr. 99] AFFIDAVIT OF ED C. CONNOR

I am consulting engineer by profession, having received the degree of Civil Engineer from the University of Texas in 1904 and the degree of Bachelor of Science from the same school in 1905. From that time until 1918, I was variously engaged in engineering work in connection with railway companies. In 1918, I became chief engineer to the Supervisor of Public Utilities of Dallas, Texas. Since 1920, I have been engaged in consulting practice, specializing in public utility work, and particularly in work involving natural gas properties and projects.

I have done engineering work for the Lone Star Gas Company, Houston Gulf Gas Company, Fort Worth Gas Company, Arkansas Natural Gas Company, among other

clients, and have made numerous investigations and reports on large natural gas projects for investment Bankers in New York, Tennessee and Texas. I have made valuations of natural gas properties aggregating more than one hundred millions of dollars and have prepared preliminary estimates on cost of construction, cost of operation and probable income on numerous gas pipe line projects involving the transportation and delivery of gas over hundreds of miles, and am familiar with and have a knowledge of all phases of the natural gas business and industry.

I made a special study of the practicability of the use of zone rates or any form of city gate rates for natural gas to be distributed for domestic use, that is based upon an attempt to allocate the cost of gas delivered to the city gates of individual cities. In none of the projects which which I have been associated were rate structures of this form applied. The enforced application of such rate structures would have prevented the consummation of these projects. Large natural gas pipe line systems with reference to their physical structure fall into two classes:

[fol. 100] 1. Those which consist of a large trunk line that extends more or less directly from the sources of supply to some large terminal market.

2. Those which are composed of a network of trunk lines that cover a large market area and which receive their gas supply from many sources, located at various points upon the pipe line system.

I am familiar with the system of Cities Service Gas Company and it conforms to the second classification above mentioned.

In the case of pipe line systems with these physical characteristics, it would be impossible to determine the cost of gas delivered to any specific community for the following reasons:

(a) As a matter of operating necessity the proportionate withdrawals from the various sources of supply vary from day to day and this variation would disturb any predetermined city gate rate which had as its basis the length of haul of the gas.

(b) The gas fields decline in production and are ultimately depleted. At other locations on the system, new

fields are developed. With the decline and abandonment of some sources of supply and with the introduction of other sources of supply at different locations on the system, there would be a constant shifting of a rate structure, based upon length of haul.

(c) The cost of production of gas various in individual fields. The withdrawal of gas causes a corresponding decline in individual wells and in the pressure of the gas in the field as a whole. With the decline in production per well, more wells are required to produce a given amount of gas, and with the decline in pressure, constantly increasing investments for compression are required. With each variation in the cost of gas produced in each source of [fol. 101] supply there would be a corresponding change in the cost of gas delivered to each city located on the system.

The annual load factor (the rate of the maximum day's demand to the average daily demand) created by the domestic use of natural gas in any given community is a function of the cost of gas delivered to this community. There is a variation in the load factor in the various cities located on any large natural gas system, and a variation from year to year in the load factor of the individual cities themselves. These variations cannot be anticipated nor predetermined.

The overall load factor in any given community, that is, the load-factor developed by the combined sale of gas for industrial and domestic use is a function of the cost of gas delivered to this community. The sale of industrial gas varies widely in the different cities located on any large natural gas pipe line system, and varies widely from year to year in individual cities. Consideration of this factor alone would cause discrepancies in the domestic gate rates of cities similarly located on a pipe line system, which would be inimical to the public interest.

An attempt to apply any schedule of city gate rates for natural gas to be distributed for domestic use, that is based upon zones of cost or an attempted allocation of the cost of gas to individual cities would have the practical effect of throwing the industry into confusion, of curtailing new development, of causing the establishment of rates that in some cases would force the abandonment of service, and

that the experience of the natural gas industry has proven this to be true.

[fol. 102] The above and foregoing is a correct, condensed statement of testimony of evidence essential to the decision of the questions to be presented by the appeal in the above entitled matter.

Robert D. Garver, Robert Stone, Attorneys for Plaintiff.

We agree that the above statement is true and correct, and is a condensed statement, and we consent that it may be approved by the court or judge as such statement, as provided under Rule 75, and hereby waive time and place of notice of the allowance thereof.

R. T. McCluggage, S. C. Bloss, Chas. W. Steiger, E. H. Hatcher, Attorneys for Defendants.

ORDER APPROVING STATEMENT OF EVIDENCE

The above and foregoing is a simple and condensed statement of the evidence in the above entitled case essential to the decision of the questions to be presented by appeal. The court directs that the portions of the testimony reproduced in the exact words of the witnesses may be so set out and hereby approves and allows this statement, and the same may be filed with the clerk and become a part of the record for the purpose of appeal.

Orie L. Phillips, Judge. J. Foster Symes, District Judge. Richard J. Hopkins, District Judge.

[fol. 103] IN UNITED STATES DISTRICT COURT

PRÆCIPE FOR TRANSCRIPT—Filed Aug. 17, 1931

To the Clerk of the above-entitled Court and to the attorneys for appellees in the above-entitled action:

You are hereby notified that the Appellant in the above entitled action designates for a transcript of the record herein as requisite for the hearing of said cause in the appellate court, and the Clerk is hereby directed to em-

body in said transcript the following portions of the record (exclude captions and all formal parts):

1. Petition for appeal.
2. Assignment of Errors.
3. Order of Court allowing appeal.
4. Bond for appeal showing approval by judge.
5. Notice of appeal, and acknowledgment of service.
6. Citation showing service acknowledged.
7. Order assembling three-judge court.
8. Service of notice on Governor and Attorney-General.
9. Amended Bill of Complaint.
10. Answer.
11. Order of June 26, 1931, denying motion for temporary injunction and dismissing amended bill of complaint.
12. Condensed statement of evidence.
13. Findings of fact and declarations of law.
14. All other orders or decrees of the court not herein especially enumerated.
15. All opinions of the court or of any judge.

Robert D. Garver, Robert Stone, Solicitors for Plaintiff.

Copy of the above and foregoing præcipe was by me served upon E. H. Hatcher, solicitor for defendants-appellees, July 27, 1931.

Robert Stone, Solicitor for Plffs.

[fol. 104] Clerk's certificate to foregoing transcript omitted in printing.

[fols. 105 & 106] IN SUPREME COURT OF THE UNITED STATES

STATEMENT OF POINTS RELIED UPON BY APPELLANT AND DESIGNATION TO PRINT ENTIRE RECORD—Filed Oct. 1, 1931

The appellant relies upon the following points for the review of the order of the court below denying its application for an interlocutory injunction and the dismissal of its bill:

(1) The hearing upon said application for an interlocutory injunction being de novo, the appellant was entitled to

an independent investigation and determination by the court of both the facts and the law tendered by its bill. The question before the court was whether or not the appellant was deprived of its property without due process of law by [fol. 107] the enforcement of the order of the Public Service Commission of which complaint is made. The question was not whether or not the appellant had made an adequate or sufficient showing before the Public Service Commission.

(2) The court below did not determine for itself the fact of confiscation but held that the appellant had not made a sufficient showing before the Commission of the inadequacy of its rates, and based its order denying the interlocutory injunction and dismissing the bill upon the inadequacy of the showing before the Commission rather than upon the issue of confiscation presented by the bill. The court did not determine or even consider the issue of whether or not the enforcement of the Commission's order would result in the confiscation of plaintiff's property. This is shown by findings of fact numbered IX and XII, (Original R. 48; Printed R. —) wherein the court states that appellant was denied the relief prayed for "solely on the ground that it had failed to justify (before the Commission) its operating expense as to" such items.

(3) There was no claim by appellee of bad faith on the part of the appellant in the presentation of its case before the Commission or in withholding evidence from the Commission but only that it did not show the cost to the Cities Service Gas Company, the supply company (a company affiliated with the appellant) of the gas supplied to appellant at the city gates of El Dorado and did not show the cost to Henry L. Doherty & Company of service rendered to the appellant for which appellant paid $3,454.43, or [fol. 108] the cost to the Gas Service Company (a company also affiliated with the appellant) of services rendered by the Gas Service Company to the appellant for which appelland paid $5,970.11. Both of the items of $3,454.43 and $5,970.11, totaling $9,424.54, may be entirely eliminated from the controversy because under the evidence the appellant lacks more than $40,000 of receiving sufficient return to pay its operating expense. The amount of the payment to the Gas Service Company for service of $5,970.11, as well as the amount paid to Henry L. Doherty & Company of

$3,454.43, are shown by Finding Number IX. (Original R. 48; Printed R. —.) It was stipulated that the territory served by the pipe line or supply company could not be segregated into separate zones for the purpose of fixing different costs of gas at the city gates in different zones. (Finding XIII, Original R. 48; Printed R. —.)

It was therefore evidently impossible to show the cost to the supply company of gas furnished to the appellant at the city gate at El Dorado as distinguished from the cost of delivering gas to other cities upon the system. It was shown before the Commission that the Cities Service Gas Company had the only source of supply available to the appellant and that the price of gas delivered by the supply company to each of the distributing companies on its system in Kansas and in Missouri was upon the uniform basis of 40¢ at the city gate without reference to the distance from the gas wells, (except as to a few unimportant points where a local supply of gas was available) and that [fol. 109] the price was uniform to distributing companies whether affiliated with the supply company or unaffiliated with it. The Commission also announced that it took judicial notice of the fact that the reasonableness of the cost of gas to the distributing companies had been adjudicated in two former cases involving the distributing company at Wichita, one of said cases having been decided by the Supreme Court of the State of Kansas and the other by the United States District Court for the State of Kansas. Therefore, it is and was the contention of the appellant that a prima facie case was made before the Commission. No charge of bad faith in the presentation of the case having been made, it became the duty of the lower court to enter upon an investigation of the facts and of the law and make its own determination as to whether or not the rates complained of were confiscatory.

(4) The majority of the court erred in refusing to make a finding of fact containing the substance of requested finding VII a. (Original R. 48; Printed R. —.)

(5) Prior to the filing of this case, the appellant exhausted its administrative remedies before the Public Service Commission even though its showing before the Commission as to certain minor items might be regarded as inadequate or insufficient to warrant the Commission in

considering such items, which it denies, and the issue of confiscation tendered in this case should have been determined by the statutory court and not brushed aside by the majority of the court holding that the showing before the Commission upon certain minor items was insufficient and therefore dismissing the bill.

[fol. 110] The foregoing points are intended to state the substance of the assignments of error which for the convenience of the court are reprinted herein and are as follows:

Comes now the said The Western Distributing Company, plaintiff in the above entitled cause, and files the following assignment of errors, upon which it will rely upon the prosecution of the appeal herewith petitioned for in said cause from the decree of this court entered on the 26th day of June, 1931.

I

The court erred in denying the application of the plaintiff for a preliminary injunction.

II

The court erred in the dismissal of plaintiff's bill of complaint and of said cause.

III

The court erred in holding that the plaintiff recover nothing under its bill of complaint and that judgment be entered in favor of the defendants herein.

IV

The court erred in refusing to make a finding of fact requested by the plaintiff (VII-A) as follows:

"The reasonablesness of this rate was found and adjudicated by the Supreme Court of Kansas as to the City of Wichita, Kansas, in the case of City of Wichita v. Public Service Commission, said decision being reported in 126 Kansas 220; — Pacific —, and by this court in case numbered 1171-N, in Equity, final decree of which was entered [fol. 111] in September, 1930. It is admitted by the pleadings that in this last mentioned proceeding, evidence was introduced showing that in November, 1928, the reasonable

value of the system of the Cities Service Gas Company was more than $83,000,000.00 and that the rate of 40 cents per thousand cubic feet for gas sold for domestic purposes to the several distributing companies served by the pipeline system would make a return to the pipeline company of less than eight per cent (8%) on such valuation."

V

The court erred in its conclusion of law that the plaintiff had failed to exhaust its administrative remedy before the Commission.

VI

The court erred in its conclusion of law that the complaint should be dismissed at the cost of the plaintiff.

Wherefore plaintiff prays that the said judgment may be reversed and for such other and further relief as to the court may seem just and proper.

Dated July 18, 1931.

The appellant deems the entire record necessary for the proper consideration of this appeal.

Respectfully submitted.

Robert D. Garver, Robert Stone, Solicitors for Appellant.

[fols. 112-114] Acknowledgment of Service

Service of copies of a jurisdictional statement and of a statement of points relied upon by appellant, prepared by it in conformity with Rules 12 and 13, is hereby acknowledged this 29 day of September, 1931, and any objection to the time of serving and filing of the same is hereby waived, and appellees join with the appellant in its request for the printing of the entire record.

Chas. W. Steiger, E. H. Hatcher, Solicitors for Appellees.

Endorsed on cover: File No. 36,151. D. C. U. S. Kansas. Term No. 337. Western Distributing Company, appellant, vs. The Public Service Commission of the State of Kansas et al. Filed August 31, 1931. File No. 36,151.

The Supreme Court of the United States

OCTOBER TERM, 1931.

No. 337.

THE WESTERN DISTRIBUTING COMPANY,
A CORPORATION,
APPELLANT,

VS.

THE PUBLIC SERVICE COMMISSION OF THE STATE OF KANSAS AND J. W. GREENLEAF, CHAS. D. SHUKERS, AND C. H. MONTGOMERY, AND THE CITY OF ELDORADO, KANSAS,
A MUNICIPAL CORPORATION,
APPELLEES.

JURISDICTIONAL STATEMENT.

(A) The jurisdiction of this court is sustained by Section 266 of the Judicial Code (28 U. S. C. A., Section 380), which provides inter alia

> "An appeal may be taken direct to the Supreme Court of the United States from the order granting or denying after notice and hearing, an interlocutory injunction in such case."

(B) The decree or order sought to be reviewed herein was entered by a statutory three-judge court consisting of Circuit Judge Phillips and District Judges Symes and Hopkins, on June 26, 1931. (Original R. 48, Printed

R. —). The application for appeal and assignment of errors was presented on the 18th day of July, 1931, and allowed on the 23rd day of July, 1931. (Original R. 68, Printed R. —)

(C) The bill of complaint filed by appellant, plaintiff below, against the appellees, defendants below, in the District Court of the United States, for the District of Kansas, alleged (Original R. 14, Printed R. —) diversity of citizenship, jurisdictional amount, the lack of adequate remedy at law; that plaintiff is the owner of a natural gas distribution system in the City of El Dorado, Kansas; that its schedule of rates are inadequate and do not yield a fair and reasonable return upon its property, used and useful in supplying natural gas to the citizens of said city, but on the contrary fail in the sum of approximately $40,000.00 per year to produce a return sufficient to pay operating expenses, without anything whatever for return or depreciation; that it applied to the said Public Service Commission for an increase in rates, which application was by the Commission denied; that said denial resulted in the taking of plaintiff's property and the use thereof without due process of law and denies to it the equal protection of the law, all in violation of the Constitution of the United States and especially the Fourteenth Amendment thereto. The bill of complaint contains an appropriate prayer for relief, asks for a restraining order and temporary injunction, as well as a permanent injunction, against the defendants from enforcing the order of the Commission of August 17, 1920, enforcing the existing rates,

and from interfering with the plaintiff putting in reasonable rates until such time as some lawful authority may approve a lawful schedule of rates. (Original R. 17, Printed R. —) Notice was served upon the Governor and Attorney General of the State of Kansas, as provided by said Section 266, and a three-judge court was assembled. The matter came on for hearing on May 18, at which time an order was entered allowing plaintiff to file an amended bill of complaint, and time was fixed for the filing of affidavits and counter-affidavits. The matter came on for further hearing, and on the 26th day of June, 1931, after the introduction of evidence and the hearing, findings of fact and conclusions of law were made by the court and a decree was entered denying the application for interlocutory injunction and dismissing the bill. (Original R. 48; Printed R. —)

(D) The provisions of the statute are so clear and familiar that a citation of authorities supporting the jurisdiction of the court below and direct appeal from the District Court to the Supreme Court, that a citation of authorities seems unnecessary. On both points, see Judicial Code Section 266, amended, and 28 U. S. C. A. 380, and cases cited thereunder. The amendment to this section extended the procedure requiring three judges to an order made by an administrative board or commission when such order is alleged in the application for the interlocutory injunction to be violative of the Federal Constitution. (Louisville R. Co. v. Alabama R. Commission, 208 Federal 35; Prendergast v. Telephone Company, 262 U. S. 43, 43 S. C. 466; Okla-

homa Natural Gas Company v. Russell, 261 U. S. 290, 43 S. C. 353; Van Wort Gas Light Company v. P. U. C., 299 Federal 670; C. R. I. & P. R. Co. v. U. S., 6 Federal (2d) 888; Smith v. Wilson, 273 U. S. 388, 47 S. C. 385.) The Supreme Court of the United States has jurisdiction of direct appeal from a decree under this section dismissing bill to enjoin State P. U. C. from enforcing statute where interlocutory injunction had been applied for and restraining order issued. (Clark v. Poor, 274 U. S. 554, 47 S. C. R. 702.)

For the convenience of the court, we are attaching hereto as Exhibit "A", complete index of the pleadings, orders, and proceedings had before the United States District Court.

Respectfully submitted,

ROBERT D. GARVER,
ROBERT STONE,
Solicitors for Appellant.

EXHIBIT "A".

INDEX.

	Page
Citation with acknowledgment of service	1
Waiver of citation	2
Motion for preliminary injunction	3
Notice of hearing	4
Order setting down motions for hearing on April 13, 1931	4
Notice of hearing before three judge court	5
Order overruling motion to dismiss, granting leave to file amended bill instanter, etc.	8
Opinion on motion to dismiss	9
Amended bill of complaint	14
Answer to amended bill of complaint	31
Decree	48
Findings of facts	48
Conclusions of law	55
Opinion by Judge Phillips	57
Opinion by Judge Symes	60
Opinion by Judge Hopkins	64
Petition for appeal	68
Order allowing appeal	68
Assignment of errors	69
Bond of The Western Distributing Company on appeal	70
Condensed statement of evidence essential to decision of questions presented on appeal	72
Testimony of Fred H. Rice	74
Testimony of B. C. Adams	78
Testimony of Fred H. Rice, recalled	84
Statement and motion by Mr. Steiger	84
Affidavit of Thos. R. Weymouth	92
Affidavit of Floyd C. Brown	93
Affidavit of H. D. Hancock	96
Affidavit of Ed C. Connor	99
Approval by Court	102
Praecipe for transcript	103
Clerk's certificate to transcript	104

FILE COPY

FILED
JAN 2 193
CHARLES ELMORE C
CL

No. 36151.

In the

Supreme Court of the United States

October Term, 1931.

No. 337.

WESTERN DISTRIBUTING COMPANY, *Appellant*,

vs.

THE PUBLIC SERVICE COMMISSION OF THE STATE OF KANSAS ET AL.

Appeal from the District Court of the United States for the District of Kansas.

BRIEF ON BEHALF OF APPELLANT.

ROBERT D. GARVER,
Kansas City, Missouri,
ROBERT STONE,
Topeka, Kansas,
Solicitors for Appellant.

SMITH-GRIEVES, LAW PRINTERS, KANSAS CITY, MO.

FILE COPY

No. 337.

FILED
OCT 1 1
CHARLES ELMORE

IN

THE SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1931

THE WESTERN DISTRIBUTING COMPANY,
A CORPORATION,
APPELLANT,

VS.

THE PUBLIC SERVICE COMMISSION OF THE STATE OF KANSAS AND J. W. GREENLEAF, CHAS. D. SHUKERS, AND C. H. MONTGOMERY, AND THE CITY OF ELDORADO, KANSAS, A MUNICIPAL CORPORATION,
APPELLEES.

JURISDICTIONAL STATEMENT.

ROBERT D. GARVER,
Kansas City, Missouri,
ROBERT STONE,
Topeka, Kansas,
Solicitors for Appellant.

JONES & [illegible], TOPEKA

In the

Supreme Court of the United States

October Term, 1931.

No. 337.

WESTERN DISTRIBUTING COMPANY, *Appellant*,

vs.

THE PUBLIC SERVICE COMMISSION OF THE STATE OF KANSAS ET AL.

BRIEF FOR APPELLANT.

Opinions of the Court Below.

The opinions of the Court below were not reported but appear in the record of this proceeding at pages 49, 50, 53 and 56, with the decree at page 42 and an opinion overruling the first motion to dismiss at page 8.

Paragraph 1 of Rule 12.

Paragraph 1 of Rule 12 has been complied with and this Court has held that it has jurisdiction to entertain the appeal.

STATEMENT OF THE CASE.

This is an appeal from an order and decree (R. 42) of a duly constituted three-judge statutory Court (in the District of Kansas) consisting of Orie L. Phillips, C. J., J. Foster Symes, D. J., and Richard J. Hopkins, D. J.

The decree denied the application of appellant for temporary injunction and dismissed the cause. The matter had been submitted upon the issues joined by the amended bill (R. 12) and the answer thereto (R. 27).

A motion for temporary injunction was filed (R. 2), due notices were served upon the Public Service Commission, the Governor and the Attorney General (R. 3) and the statutory court was convened. At the first session, May 19th, 1931, a motion to dismiss the bill was overruled with the understanding that an amended bill might be filed and the parties might stipulate as to relevant facts respecting the proceedings before the Commission (R. 6).

In the opinion overruling this motion (R. 8) the Court construed the Kansas statute respecting review of proceedings before the Public Service Commission (R. 9), cited a decision of the Kansas Supreme Court construing that statute (R. 11) and held that the statute did not provide an exclusive remedy and could not prevent plaintiff from obtaining a determination as to whether or not its rates are confiscatory, by a judicial tribunal upon its own independent judgment as to both law and facts, citing the Ben Avon case, 253 U. S. 287 (R. 11). From this ruling neither party appealed.

The hearing was continued until June 25th, 1931; an amended bill and answer were filed; certain facts respecting the hearing before the Commission were stipulated and affidavits were filed (R. 62-89).

The motion to dismiss the amended bill was renewed and the Court sustained the motion (R. 42) and made findings of fact (R. 43) and conclusions of law (R. 48).

There was no objection to any of the findings of fact but appellant requested an additional finding (VIIa, R. 45), which was refused, Phillips, C. J., dissenting (R. 47), to which refusal appellant objected and was allowed an exception (R. 45). To the decree which was filed on June 26th, 1931, appellant objected and was allowed exceptions (R. 42), and to each of the conclusions of law appellant also objected and was allowed exceptions (R. 49). On July 18th, 1931, appellant filed its petition for appeal (R. 59), which was allowed July 23rd, 1931 (R. 60); assignments of error were filed July 18th, 1931 (R. 60), and bond for appeal was filed and approved July 24th, 1931 (R. 62). A condensed statement of the evidence essential to a decision of the questions presented on appeal appears at pages 62 to 90, inclusive, of the record and a statement of the points relied upon by the appellant may be found in the record at page 90. Acknowledgment of service upon the appellees appears at record page 95.

History of Proceedings.

In order that the Court may more readily understand the proceedings had before the defendant Commission and the manner in which they were conducted by the plaintiff, we ask the indulgence of the Court in briefly outlining the situation which existed at the time of the hearing.

In the year 1916, and for some time prior thereto, The Kansas Natural Gas Company, The Wichita Natural Gas Company, The Quapaw Gas Company and other then existing units, each being a supply gas pipe line company, now combined in the Cities Service Gas Company, were all in financial difficulties and unable to render service. In that year the control of their capital stock was purchased by Cities Service Company. Prior to that time no subsidiary of Cities Service Company or company affiliated with it, through stock ownership or otherwise, had been engaged in the gas transportation business in Kansas and no distributing companies in Kansas were affiliated with Cities Service Company through stock ownership or otherwise other than The Western Distributing Company operating in El Dorado and a few small towns in that vicinity.

Years of litigation involving The Kansas Natural Gas Company and other companies followed, receivers were appointed and such companies were operated by the receivers until about the year 1922 when they were turned back to their respective officers. In the course of this receivership city gate rates to the various cities receiving their supply from the several pipe line companies above mentioned were changed and increased, resulting in a city gate rate of thirty-five cents (35c) established by the order of Judge Booth, then assigned to this Court for that case.

Several years of experience under this rate demonstrated its insufficiency and in 1922 the companies—at that time The Kansas Natural Gas Company and The Empire Natural Gas Company—applied to the Kansas Commission for an increase in rates. After a full investigation and valuation of the two systems by both the engineers for the companies and the engineers for the

Commission, an order was entered March 21st, 1923, increasing the rate from thirty-five cents (35c) to forty cents (40c), the Commission's order reciting:

> "(The Commission is of the opinion that it is not necessary to set forth special elements of value, for the reason that on the lowest valuation submitted to it by any of the witnesses in the case (including the Commission's engineer) the total amount for depreciation and return under a 35c rate in effect at present is less than 2%, which is obviously an insufficient and unreasonable return."

Under Sec. 66-115, R. S. of Kansas 1923, a rate so established is made *prima facie* reasonable.

At the time this order was issued no distributing companies were affiliated with Cities Service Company, with the exception of El Dorado and a few small towns in the vicinity thereof, the distributing companies in the cities which supplied the necessary market for the pipe line system being owned and operated by companies not associated with and actively antagonistic to the pipe line company.

Several years' experience under the forty cent (40c) rate demonstrated to the pipe line companies the fact that they could not continue to exist even on a forty cent (40c) rate and make the expenditures then and in the future to be required to procure a supply of gas from distant fields due to the exhaustion of the fields then connected unless control was acquired of the distributing companies in the major markets in order to increase the consumption of gas in such markets to such an extent as to justify the operation of the lines and the making of the required expenditures.

Many millions of dollars were spent by Cities Service Company in the next few years acquiring the capital

stock of the distributing companies at Wichita, Hutchinson, Newton, Pittsburg, Topeka, the two Kansas Citys the twenty-five towns comprising the Union Public Service Company group and in Missouri, Joplin, Webb City Carthage, Carterville, St. Joseph, Springfield and other cities.

Millions of additional capital were then thrown into the pipe line systems and lines extended to new fields in Oklahoma and Texas.

As a result of the affiliation of such distributing systems and the work done in encouraging the additional use of gas, the consumption in Wichita per customer per year was practically doubled, and the consumption in all other cities raised from 25 to 75 per cent. This increase in business, which could not have been procured without the cooperation of the distributing companies and the pipe line company, resulted in a market which made possible an adequate supply and justified the operation of the lines in a condition to render 100 per cent service.

In part due to the fact that the supply and distribution companies were affiliated in a common group no contracts were entered into between the several distributing companies and the supply company other than an oral day to day agreement, the companies being all left free to purchase gas, if offered, at any price less than the price established by the affiliated supply company, and such gas is now being purchased wherever offered and constitutes a substantial part of the supply for many towns connected to the pipe line system, such as Parsons and Cherryvale and the saving is passed on to the consumer.

In 1925 applications for reduced rates to ultimate domestic consumers were filed with the defendant Commission by the cities of Wichita, Hutchinson and Newton. These applications resulted in an order unsatisfacto

the distributing companies involved and litigation in the Kansas Shawnee County District Court followed. T. M. Lillard of the Shawnee County bar was appointed referee, numerous hearings were held and all the evidence introduced which either party desired. This litigation resulted in a permanent injunction against the Commission's order and in a finding that the city gate rate of forty cents (40c) was reasonable and that the charges made by Henry L. Doherty & Company and by The Gas Service Company were reasonable and proper. (Admitted Ans., Par. IX, R. 35.)

This case was appealed by the Commission and affirmed by the Supreme Court of Kansas June 9th, 1928, the opinion being reported in 126 Kansas 220.

While these three cases were pending undertermined in the Supreme Court of Kansas, the City of Wichita filed a second application with the defendant Commission, which resulted in its order of August 10th, 1928, in direct conflict with the decision of the Supreme Court handed down only two months previous.

Being dissatisfied with this order, The Wichita Gas Company filed an injunction proceeding in the District Court of the United States for the District of Kansas, in which proceeding J. D. M. Hamilton of the Shawnee County bar was appointed master and testimony was taken at great length over a period of a year or more. In this proceeding the principal issue contended for by the Commission was the unreasonableness of the forty cent (40c) gate rate. Evidence at greater length than in any other proceeding was introduced in an effort to satisfy the Commission, as well as the Court, of the reasonableness of the rate and end the constant criticism of it. The result of this proceeding was the order of said Court signed in September, 1930, by Honorable

INDEX.

	PAGE
Opinions of Court Below	1
Paragraph 1 of Rule 12	1
Statement of Case	2-3
History of Proceedings	3-20
Specification of Assigned Errors	21-22
Summary of Argument	22-24
Argument:	
As to Assignment of Error No. IV	25
As to Other Assignments of Error	26-51

Table of Cases and Statutes Cited.

City of Hutchinson v. Hutchinson Gas Co., 125 Kan. 337. 9

East Ohio Gas Co. v. Tax Commission, 283 U. S. 465. 30-35

Missouri v. Kansas Natural Gas Co., 265 U. S. 298. 23-30-32-35

Public Utilities Commission v. Landon, 249 U. S. 236. 22-30-32-35

Railroad & Light Co. v. Court of Industrial Relations, 113 Kan. 217. 9-41-42-43-44

Smith v. Illinois Bell Telephone Co., 282 U. S. 113. 11-23-26-28

Wichita Gas Co. v. Public Service Commission, 126 Kan. 220. 6-37-46-47

Wichita Gas Co. v. Public Service Commission, No. 1171-N, In Equity. 7-38-47-48

Sec. 66-115 R. S. Kan., 1923. 5

as court and counsel. But why should it take 'approximately a year' to secure a new hearing and order from the Public Service Commission after its prior order has been held confiscatory or non-compensatory? Why should it take more than half a day? All the facts will have already been ascertained. The data already gathered by the Commission and the facts established in court proving the old rates too low will be at hand, and an approximately correct rate can be deduced therefrom by a simple mathematical computation."

From what we have said and from the decisions we have quoted it must be apparent to the Court that appellant appeared before the Commission believing that it would abide by its solemn agreement made in open court and recited in the decision of the Court, and that it would not be asked to again and within four short months relitigate the entire valuation, financial experience and rates of the pipe line company.

Appellant accordingly introduced the decision of the Supreme Court of Kansas and the decision of the Federal Court as handed down by Judge McDermott.

On page 18 of defendants brief below it is stated: "It is true that these decisions were offered in evidence, but the record of the decisions was not offered." This record was subsequently introduced by the applicant, but when the statement was made by Mr. Steiger, attorney for the Commission, as appears from the record (R. 78), that he would object to its introduction, the offer was withdrawn, applicant appreciating that under the strict rules of evidence the record was not admissible over objection. All of this, however, becomes entirely immaterial in view of the fact that appellees, in their answer to the

amended bill of complaint, paragraph 13, page 38, of the record, allege:

> "It is admitted that the defendant Public Service Commission should and did take notice of the decision referred to *and the respective records,* but it is averred that the defendant City of El Dorado has and had no knowledge thereof." (City was not a party before the Commission.)

In addition to the decisions of the two courts appellant introduced the evidence shown in Finding XI (R. 46), and, in its opinion, established a *prima facie* case, as to the reasonableness of the city gate rate.

Had it not been for the decision in the case of *Smith* v. *Illinois Bell Telephone Company,* there is no question but that the Commission would likewise have considered the showing made sufficient. In regard to its promise to abide by the decision of the Federal Court, appellees say in their brief below, page 18:

> "That was perhaps true, so far as the opinion of both parties existed with reference to the then existing law. * * * Since that time the courts have presented a different theory of the law (*Smith* v. *Illinois Bell Telephone Company*) and in attempting to find the cost of furnishing gas and the rate of return earned by the holding company the Commission is abiding by the latest decision of the Federal Supreme Court."

There is no question but that the Commission and its attorneys, had the Smith case not then been decided, would not have required a relitigation of the reasonableness of the city gate rate. On page 21 of their brief

below they reiterate the promise made in court in the proceedings before Judge McDermott, for they state:

> "This information once obtained and properly made in exhibit form could be used in each of the cities under the control of the distributing companies, and so far as time and financial output is concerned, their introduction in separate cases would not consume fifteen minutes."

And again:

> "The Commission will be satisfied once a complete investigation of the pipe line company is made and the books of the company audited, and it will be willing to take the gate rate found after such investigation and use it as a starting point for future rate cases."

The above is quoted to show the state of mind of the Commission then and now in regard to not requiring a continued relitigation of matters once adjudicated. This language, however, is all meaningless if the Commission insists on an application of the Smith case, for in that case the court held as to the dealings between the Chicago Company and the Western Electric Company that it was not sufficient to show over-all experience and remanded the case for an express showing as to the cost of service rendered Chicago as distinct and separate from all other cities in the Bell system. An application of this rule would mean that in every rate case the cost of gas at the city gate of every city distinct from all others should be shown.

The motion of the Commission's attorney to dismiss the proceeding was based entirely upon the Smith case and the objection to the introduction of the record in the

former cases was likewise based thereon. In other words, *had it not been for the decision in the Smith case the Commission would have accepted Judge McDermott's decision as a starting point and would not have dismissed the proceeding.* Now, while admitting that previous to the Smith decision the Commission had no jurisdiction or authority over the pipe line gate rate (page 18 of brief below) the defendants state that while they are not "in any way attempting to fix a pipe line rate which the pipe line company must charge but only to determine what the affiliated company should be allowed to charge to its expense item in determining a proper rate for the distributing plant," they are undertaking to do indirectly what they admit they could not do were it not for the Smith decision.

It must be borne in mind that the Commission was not at this time contending that the pipe line company was making an excessive return under the forty cent (40c) city gate rate, but was contending that under the Smith case the distributing company, by reason of its affiliation with the pipe line company, must show not the over-all experience of the pipe line company and the reasonableness of its return as to all its business, *but the cost of serving gas to the City of El Dorado independent of any other city or market on its line.*

As the motion to dismiss was the sole basis for the action of the Commission in dismissing appellant's application and denying it relief, we quote it in full (R. 74, 77):

> "May it please the Commission, at this time the attorneys for the Commission desire to present a matter to the Commission which has never been presented in like manner in my experience with the Commission, or has it ever been presented in like

form in the past, so far as my knowledge and experience goes.

Very recently there was a very important decision handed down by our Supreme Court, and the Supreme Court, in speaking through its chief justice, has apparently, using the common everyday language, made a new law; that it departed to a great extent from their decisions and rulings heretofore made in rate matters. They have apparently taken into consideration other necessary facts which can be determined, and upon which there must be competent testimony to determine, into consideration. Now, that has never, in the history of our Supreme Court, been taken into consideration in prior proceedings, and just recently, in a Supreme Court decision handed down by, I think, Chief Justice Hughes—although I am not certain as to that—the advance sheets of which have not been published, but only generally speaking, the decision in the Florida case, which I refer to from information at hand, is apparently of very far-reaching importance, just decided within the last three or four days; it is one which Mr. Benton communicated with us about. I mention it only as incidental to what I desire to take up and only for the purpose of stating that apparently the Supreme Court of the United States is getting back now more and more to the law applicable to state regulation, wherein it is possible for the state commissions to function.

I want to briefly read from the Illinois case; that is the case we are familiar with, to a certain extent. I will read from the syllabi first.

Mr. Garver: I think you should make your motion and argue it afterwards, rather than make the argument in the motion.

Mr. Steiger: Sometimes one lawyer does things differently from what some other would do, and you, perhaps, would go at it right, and make your motion first; I, perhaps, am going at it in the wrong way and making my statement first.

(Here Mr. Steiger read from the decision referred to.)

And in this connection I want the Commission to keep in mind the same identical set-up of companies involved in the Illinois telephone litigation, such as parent company and subsidiary companies, has the same identical set-up in this case, except in the telephone case it is a matter of sale of telephone appliances and in this instant case it is the matter of selling gas, same interlocking system of subsidiary companies existing under both of these proceedings.

(Continues reading from the decision.)

In other words, in the language of Chief Justice Hughes, the State Commission, in determining the fair basis of rate in the Illinois case, did not take into consideration at all as to the fairness of the price purchased from the Western Electric Company upon the telephones used:

On the record in this suit, the court concluded that the city had failed to support its contention that these prices were exorbitant. The court said that it appeared that for the past fourteen years the average profit of the Western Electric Company on its total business had not been 'In excess of seven per cent and never above ten per cent.'

Mr. Adams, in his testimony, stated to this Commission that he did not know, and did not claim to know what the profits or earnings were of the Cities Service Gas Company, because that is a company of which he had no knowledge or control, and was not furnished with that information.

(Continues reading from the decision.)

In other words, the Supreme Court has directed the lower court to make findings as I have read to you.

There is absolutely nothing in this evidence upon which you can predicate an order that the gas at the city gate is fair and reasonable, and there is no evidence at all showing any cost of that service to

the Western Distributing Company, which the Supreme Court has directed the lower court to ascertain in the Illinois Bell Telephone case.

Now I picked up a little magazine published by the General Utilities Association. I think it is a very fair magazine. On the front page of it, it says this:

(He then reads from the magazine.)

That, up until this Illinois decision was the law of the land affecting public utility rate questions. Now, here is what they say:

'But in this latest case, the court, holding that the companies were all parts of one integrated system, recognizes a new element. It holds that the cost of rendering the service, or of manufacturing the article, by the parent or affiliated company, is a factor which must have consideration.'

And there is no evidence, if the Commission please, in this proceeding at all, as to the cost of the services rendered by the Doherty Company nor the cost of the services rendered by the Gas Service Company or the reasonableness, or justness of any cost which they may make. Now, in conclusion, this article concludes:

'It is readily seen that the distinction between the two tests is a real one, and that it may have far-reaching consequences in its application to similar corporate relationships.'

So, therefore, for the reasons stated, and without reiteration, I move, and on behalf of your legal department, Mr. Hatcher and I are in entire accord in our procedure, move that the application of the Western Distributing Company for an increase in rates to the gas consumers in the City of Eldorado be denied."

Being dissatisfied with the refusal of the Commission to grant relief from most apparent confiscation appellant filed its bill in the court below, alleging with great

particularity the proceedings before the Commission, the value of appellant's property and its failure for many years to earn even operating expenses with nothing whatever for return and depreciation. It asked the court to exercise its independent judgment as to both the law and the facts and to grant relief from the confiscation of its property, which appellant had been suffering for many years (R. 12).

The appellees filed a motion to dismiss the bill and to deny relief on the ground that appellant had failed to make a proper showing before the Commission as to the reasonableness of the price it was paying the Cities Service Gas Company, affiliated with it through stock ownership, for gas at the city gate and had also refused to satisfy the Commission as to two items of its operating expense, one item being the sum of $3,454.43 paid to Henry L. Doherty & Company and the other an item of $5,970.11 paid to The Gas Service Company. The last two items are immaterial to the consideration of this case, as will be hereinafter pointed out, appellant having at all times, through the proceedings before the Commission and the court below, offered to eliminate these items if the Commission or the court were not entirely satisfied with their reasonableness.

The court declined to pass on the motion of appellees to dismiss for the reason that it alleged facts not appearing on the face of the bill and required appellees to raise the issue by answer. This was done and on the issues raised by the bill and admitted by the answer the court below concluded that appellant had not exhausted its administrative remedy before the Commission and denied it relief.

The court below found that appellant had made its case before the Commission except as to the reason-

ableness of the price it was paying for gas at the city gate and the payments made to Henry L. Doherty & Company and The Gas Service Company and also found that the last two items could be eliminated without affecting appellant's right to relief.

Findings IX, X, XI and XII (R. 46-47) are as follows:

IX.

"Said application was duly heard by said defendant Commission, at which time it is admitted by the parties hereto that applicant's evidence was sufficient to make a *prima facie* case upon all issues except as to three items of its operating expenses, to-wit:

1. A payment of $3,454.43, being 1¼% of its gross revenue, paid to Henry L. Doherty & Company.

2. The sum of $5,970.11 paid to the Gas Service Company.

3. The cost of gas purchased from the Cities Service Gas Company at a total cost of $176,260.3., under the above mentioned city gate rate.

X.

Assuming that the rate at the city gate is reasonable, Items 1 and 2 of Finding IX could be eliminated without affecting plaintiff's right to relief and would not be necessary to a determination of the question here presented, for the reason that under the showing made by the plaintiff it is failing to make its operating expenses by an amount greatly in excess of the total of said items.

XI.

As to Item 3 of Finding IX, cost of gas at the city gate, plaintiff introduced in evidence before the Commission the decision of the Supreme Court of

Kansas and the decision of this court hereinabove referred to; and other evidence tending to show that there was no other source of supply than that of the Cities Service Gas Company; that no gas had ever been offered at a cheaper rate; that the plaintiff would have purchased cheaper gas if offered by any other company; that the cost of bringing gas to the city gate had not altered greatly for quite a few years; that there had been no change in the city gate rate since 1923; that there had been no material change in the situation since the decision of the Supreme Court of Kansas and of this court above referred to; that all cities on the Cities Service Gas Company system receive their supply from a common source; that the price is the same as to all cities not having local gas; that an effort was made to find local gas available to Eldorado but none was found; that at the time the 40-cent gate rate was established all the larger distributing companies, such as the two Kansas Citys, Topeka, Wichita, Hutchinson and Newton, were not owned or in any manner affiliated with the Cities Service Gas Company; that no change has been made in the city gate rate since the properties in those cities were acquired, and that the properties at Lawrence, Leavenworth, Atchison and other towns are now owned by outside interests and pay 40 cents at the city gate the same as affiliated companies. Plaintiff refused to introduce evidence or make any showing as to the cost of gas to the Cities Service Gas Company at the city gate of Eldorado, Kansas, and refused to offer any testimony to show whether or not the Cities Service Gas Company was making an excessive or undue profit on gas sold to the plaintiff other than the adjudications hereinbefore referred to.

George T. McDermott, who was District Judge at the time the proceedings were commenced and tried, but a Judge of the Circuit Court of Appeals at the time the decree was signed.

While the above proceeding was pending in the Federal Court a third investigation was started by the Commission on its own motion. This proceeding resulted in the Commission's order issued in July, 1930, establishing rates at Wichita agreeable to the distributing company. This rate was based on a city gate rate of forty cents (40c) to the distributing company.

In the proceeding in the Federal Court, and after a memorandum opinion had been handed down by Judge McDermott taxing all of the costs to the defendants, on motion of defendants to retax costs, a part was taxed to the plaintiff on the agreement of the defendants, in open court, to abide by that decision and use it as a starting point in future rate cases. (Dissent Judge Phillips, R. 48.)

Within four months from the time the final decree was signed by Judge McDermott and within four months from the time the Commission had agreed to abide by his decision, the proceeding, which is the basis of this controversy, came on to be heard, the same being an application by appellant for an increase in rates at El Dorado.

Little is said in the Kansas statute in regard to the nature of the proceedings before the Commission and the same have been established more by custom and the decisions of the courts than by statutory provision. The proceedings are most informal and the Commission is authorized to procure its information in any reasonable manner, it being left to the courts to correct any injustice which might result to either party.

In the case of *Railroad and Light Company* v. *Court of Industrial Relations,* 113 Kansas 217, 236, the Supreme Court of Kansas said:

> "It is not contemplated by law that proceedings before the Commission need be conducted with the formality required of judicial tribunals, nor that the facts of which the Commission may take note need conform to the law of evidence as understood by trained lawyers and judges. * * * We have said that the formalities of a judicial court need not be followed, but this is really no detriment to the parties; it facilitates the development of the facts; and it is because of the free and easy procedure permissible before the Commission that a trial *de novo,* not a mere appeal, is accorded in a judicial court from the orders of the Commission. So long as a judicial hearing *de novo* is provided, it is not very important just what sort of evidence is received by the Commission or how it is received, if the parties concerned are apprised of it."

In the more recent case of *City of Hutchinson* v. *Hutchinson Gas Company,* 125 Kansas 337, the Supreme Court was speaking as to what was necessary to be done in order for the Commission to establish a rate for a given town after its prior order concerning such town had been set aside by the courts. From the language used it is clear that the Supreme Court did not contemplate that everything should be gone over again and the strict rules of evidence applied. The Court said:

> "Appellee refers to the long interval before just and proper new rates can be lawfully put into effect, during which time any rates the utility sees fit to impose may be exacted. As to such situation, we can only remark that this court cannot function both

XII.

Plaintiff's application before the defendant Commission was dismissed and it was denied the relief prayed for solely on the ground that it had failed to justify its operating expenses as to the three items set out in Finding IX hereof. A motion for rehearing as provided by the Kansas statute was filed and overruled by the defendant Commission."

SPECIFICATION OF ASSIGNED ERRORS.

The errors assigned are as follows (R. 61-62):

I.

The court erred in denying the application of the plaintiff for a preliminary injunction.

II.

The court erred in the dismissal of plaintiff's bill of complaint and of said cause.

III.

The court erred in holding that the plaintiff recover nothing under its bill of complaint and that judgment be entered in favor of the defendants herein.

IV.

The court erred in refusing to make the findings of fact requested by the plaintiff (VII-A) as follows:

"The reasonableness of this rate was found and adjudicated by the Supreme Court of Kansas as to the City of Wichita, Kansas, in the case of *City of Wichita* v. *Public Service Commission*, said decision being reported in 126 Kansas 220; —— Pacific ——, and by this court in case numbered 1171-N, in Equity, final decree of which was entered in September, 1930. It is admitted by the pleadings that in this last mentioned proceeding, evidence was introduced showing that in November, 1928, the reasonable value of the system of the Cities Service Gas Company was more than $83,000,000.00 and

that the rate of 40 cents per thousand cubic feet for gas sold for domestic purposes to the several distributing companies served by the pipeline system would make a return to the pipeline company of less than eight per cent (8%) on such valuation."

V.

The court erred in its conclusion of law that the plaintiff had failed to exhaust its administrative remedy before the Commission.

VI.

The court erred in its conclusion of law that the complaint should be dismissed at the cost of the plaintiff.

Assignments Nos. I, II, III, V and VI all refer to the same legal question and will be discussed together.

Assignment No. IV will be discussed under a separate heading and will be first considered.

Summary of Argument.

The principal contention of the appellant in this cause is that the state of Kansas, through its regulatory body, the Public Service Commission, is without jurisdiction or authority to directly or indirectly fix the price which shall be charged by a pipe line company for gas sold in interstate commerce, notwithstanding the fact that such pipe line company may be affiliated with the distributing company to which it sells gas by reason of the capital stock of the pipe line company and distributing company being owned by a common holding company. It is our contention that the law, as announced by this court, in the cases of *Public Utilities Commission* v. *Landon*,

249 U. S. 236, and *Missouri* v. *Kansas Natural Gas Company*, 265 U. S. 298, was not changed by the decision of this court in the case of *Smith* v. *Illinois Bell Telephone Company*, 282 U. S. 133, and that the law of this case is the same as it was at the time this court held, in the case of *Missouri* v. *Kansas Natural Gas Company* with respect to this same pipe line company and this same Commission that the rates of the pipe line company were not subject to state regulation. Since the decision in *Missouri* v. *Kansas Natural Gas Company* many of the distribution companies which were at the time of that decision unassociated with the pipe line company have been acquired by the holding company which owns the capital stock of the pipe line company, or its subsidiaries, and this affiliation and the decision of this court in the case of *Smith* v. *Illinois Bell Telephone Company* have been considered by the Kansas Commission and the court below as changing the law previously announced by this Court and as having authorized and empowered said Commission to determine the reasonableness of the charges of the pipe line company engaged in interstate commerce and to limit the distributing company in its allowable operating expense for purchased gas to the rate which the Commission so finds to be reasonable. We contend that under the Constitution of the United States Congress alone has the power to regulate interstate commerce and that this is true whether the company engaged in interstate commerce sells its gas to a company with which it is affiliated or not. In the instant case the Cities Service Gas Company, engaged in interstate commerce, sells its gas to some distributing companies with which it is affiliated and to others with which it is not. It is our contention that the rule must of necessity be the same

in each instance and that the requirements of the Constitution admittedly existing before affiliation, are not changed by reason thereof and that the state Commission, which admits its lack of authority to proceed against the pipe line company engaged in interstate commerce, cannot indirectly accomplish the same purpose by undertaking to determine what price it should charge and by limiting affiliated distribution companies to the payment of that price.

ARGUMENT.

I.

Assignment of Error No. IV.

The proceedings which resulted in the decisions introduced in evidence before the Commission, and which were the basis of requested finding VIIa, are set out in appellant's bill under paragraphs IX, X, XI and XII (R. 14-18); are, in effect, admitted in appellee's answer under the same paragraph numbers (R. 35-37) and are recognized by the express admission of the Commission as follows:

> "The Commission will take notice of these decisions" (R. 64).

Admission is also made in paragraph XIII of appellee's answer (R. 38), as follows:

> "It is admitted that the defendant, Public Service Commission, should and did take notice of the decisions referred to and the respective records, but it is averred that the defendant, City of El Dorado, had and has no knowledge thereof."

The facts being undisputed we contend that the requested finding should have been made by the statutory court and that the majority of the court erred in refusing such finding for the reasons stated in the dissenting opinion of Judge Phillips (R. 48).

II.

As to Specified Errors Other Than No. IV.

All of the errors assigned, other than assignment No. IV, concern the application of the decision of this court in the case of *Smith* v. *Illinois Bell Telephone Company,* 282 U. S. 133, 75 Law Ed. 99, to this proceeding and to the peculiar facts and circumstances surrounding the natural gas industry generally.

A reading of the motion upon which the proceedings before the Commission were dismissed shows very clearly that at that time the Commission construed the Smith case as requiring a showing in every rate case as to the cost of gas to the supply company at the gate of each city where the distributing company and supply company are affiliated. Such a showing was not made before the Commission not only for the reason that it was impossible so to do but for the reason that the pipe line project of the Cities Service Gas Company, from which the City of El Dorado receives its supply, was not built up in that manner and could not continue its existence if zoning were resorted to, as an application of that theory would cause the price of gas at distant points to be so increased as to make its sale prohibitive. The facts as to the practice of the Cities Service Gas Company and similar natural gas transportation companies generally are set out in the affidavits of Thomas R. Weymouth (R. 80), Floyd C. Brown (R. 82), H. D. Hancock (R. 84) and Ed C. Connor (R. 86). When these affidavits were filed and their contents came to the knowledge of appellees they abandoned any idea they may have entertained up to that time as to the propriety of zoning the pipe line system of the Cities Service Gas

Company and determining a rate for each city thereon based upon the cost of rendering service to such city as distinguished from all other cities on the system and accordingly stipulated in the record that the system could not be zoned, which stipulation is embodied in finding No. XIII of the court below and is as follows:

> "At the hearing it was stipulated and agreed by the Commission through its counsel for the purposes of this hearing only, that the territory served by the pipeline company could not be segregated into separate zones for the purpose of fixing different costs of gas at the city gates in different zones" (R. 47).

The theory of ascertaining separate costs for separate cities having been abandoned by the appellees, the only questions remaining are as to whether or not the Commission, in a proceeding such as the application made by the Western Distributing Company for increased rates at El Dorado, has the right or authority to require a showing as to the reasonableness of the rates of a supply company engaged in interstate commerce from which it receives its gas for distribution and in this particular case as to whether or not the showing made by appellant before the Commission *prima facie* established the reasonableness of such city gate rate. It is our contention that the Smith case cannot be construed as disaffirming the many cases decided by this court in which it is held that the state cannot fix the price to be charged by a gas transportation company engaged in interstate commerce or carry its regulation to such an extent as to directly affect that price.

In the Smith case the court had under consideration a property which, of necessity, was an undivided unit

devoted to both interstate and intrastate business. One exchange handled both interstate and intrastate calls. There was but one set of poles, wires, instruments and operators; the time of all officers and employees was common to both branches of the business. As to the interstate business the Interstate Commerce Commission had jurisdiction; as to the intrastate business the Illinois Commission. Neither jurisdiction could infringe on the other. This made a separation of the physical property and earnings necessary. We quote from the decision as follows:

> "The separation of the intrastate and interstate property, revenues and expenses of the company is important not simply as a theoretical allocation to two branches of the business. It is essential to the appropriate recognition of the competent governmental authority in each field of regulation. In disregarding the distinction between the interstate and intrastate business of the company, the court found it necessary to pass upon the fairness of the division of interstate tolls between the American and Illinois companies. The court held that the division was reasonable and the appellants contest this ruling. But the interstate tolls are the rates applicable to interstate commerce, and neither these interstate rates nor the division of the revenue arising from interstate rates was a matter for the determination either of the Illinois Commission or of the court in dealing with the order of that Commission (page 148).
>
> * * * * * * *
>
> The proper regulation of rates can be had only by maintaining the limits of state and federal jurisdiction, and this cannot be accomplished unless there are findings of fact underlying the conclusions reached with respect to the exercise of each authority. In view of the questions presented in this case the validity of the order of the state commission

can be suitably tested only by an appropriate determination of the value of the property employed in the intrastate business and of the compensation receivable for the intrastate service under the rates prescribed. Minnesota Rate Cases, 230 U. S. 352, 435. As to the value of that property, and as to the revenue and expenses incident to that business, separately considered, there should be specific findings. *Railroad Commission* v. *Maxcy*, 281 U. S. 82, 83 (page 149).

* * * * * * *

The appellants insist that this method is erroneous, and they point to the indisputable fact that the subscriber's station, and the other facilities of the Illinois Company which are used in connecting with the long distance toll board, are employed in the interstate transmission and reception of messages. While the difficulty in making an exact apportionment of the property is apparent, and extreme nicety is not required, only reasonable measures being essential (*Rowland* v. *Boyle*, 244 U. S. 106, 108; *Groesbeck* v. *Duluth, South Shore & Atlantic Railway*, 250 U. S. 607, 614) it is quite another matter to ignore altogether the actual uses to which the property is put. It is obvious that, unless an apportionment is made, the intrastate service to which the exchange property is allocated will bear an undue burden—to what extent is a matter of controversy. We think that this subject requires further consideration, to the end that by some practical method the different uses of the property may be recognized and the return properly attributable to the intrastate service may be ascertained accordingly" (pages 150-151).

The case was sent back to the statutory court, not to the Commission, for this separation and allocation.

The situation as to gas distribution properties is entirely different. There is no unit of property devoted to

both interstate and intrastate business. Not only in practice but by the repeated decisions of the Supreme Court of the United States, a clear line of demarcation exists between interstate and intrastate business without regard to whether or not the pipe line and distributing companies are in common or separate ownership. In the case of *Public Utilities Commission* v. *Landon*, 249 U. S. 236, 245, the court said:

> "But in no proper sense can it be said, under the facts here disclosed, that sale and delivery of gas to their customers at burner tips by the local companies operating under special franchises constituted any part of interstate commerce. * * *
> *Interstate movement ended when the gas passed into local mains.*"

In the subsequent case of *Missouri* v. *Kansas Natural Gas Company*, 265 U. S. 298, 308, 309, the same court said:

> "With the delivery of the gas to the distributing companies, however, the interstate movement ends. Its subsequent sale and delivery by these companies to their customers at retail is intrastate business and subject to state regulation. * * *
> The business of supplying, on demand, local consumers is a local business, even though the gas be brought from another state and drawn for distribution directly from interstate mains; *and this is so whether the local distribution be made by the transporting company or by independent distributing companies.*"

These decisions were reviewed and commented upon by this court in the most recent case of *East Ohio Gas Company* v. *The Tax Commission of Ohio*, 283 U. S. 465, decided May 18th, 1931, and the court again held

that interstate commerce ended when gas passed into local mains.

The matter having been many times decided by this Court further discussion would seem unnecessary. There being an actual division between interstate and intrastate business of appellant, that part of the Smith decision which requires such separation has no possible application. That case having been sent back to the statutory court primarily for this separation both as to value and earnings it is doubtful whether such action would have been taken by the court had that issue not existed and had the question before it been merely the relationship of the Chicago Company with the Western Electric Company.

Assuming that the case would have been sent back for findings as to the cost of service by the Western Electric Company to the Chicago Company we will briefly discuss that feature of the case and show its lack of application to the case at bar.

The Western Electric Company was an affiliated corporation manufacturing instruments but was not a public utility; not engaged in interstate commerce and not regulated nor subject to regulation. If, in the instant case, an affiliated company owned and operated a pipe mill and the El Dorado plant and other affiliated distribution systems purchased their pipe from this company, the Smith case would then be applicable and a showing would be required as to the *cost* of that pipe as distinguished from its actual *selling price*. The situation of the Cities Service Gas Company, however, is entirely different. It is engaged in interstate commerce; its rates and the issue of the right of the State of Kansas to regulate the same, have been directly before this

Court and the Court has held in regard to them that the state is without power to regulate:

> "That the transportation of gas through pipe lines from one state to another is interstate commerce may not be doubted. Also, it is clear that as part of such commerce, the receivers might sell and deliver gas so transported to local distributing companies free from unreasonable interference by the state. * * *"
>
> *P. S. C.* v. *Landon*, 249 U. S. 236.

The first paragraph of the syllabus in the case of *Missouri* v. *Kansas Natural Gas Company*, 265 U. S. 298, is as follows:

> "The business of piping natural gas from one state to another and selling it, not to consumers, but to independent distributing companies which sell it locally to the consumers, is interstate commerce free from state interference. *Pennsylvania Gas Co.* v. *Public Service Comm.*, 252 U. S. 23, distinguished. P. 307."

These decision hold that by reason of the national character of the business Congress alone has authority to act and that, in the absence of action by Congress, the state cannot interfere. The silence of Congress, when it alone has power to act, is said to be equivalent to a declaration that the business shall be free from regulation.

We quote further from the case of *Missouri* v. *Kansas Natural Gas Company*, *supra*:

> "In Minnesota Rate Cases, 230 U. S. 352, 396, Mr. Justice Hughes, speaking for the court, said: 'If a state enactment imposes a *direct burden* upon interstate commerce, it must fall regardless of Fed-

eral legislation. The point of such an objection is not that Congress has acted, but that the State has directly restrained that which in the absence of Federal regulation should be free.' The question is so fully discussed in that case, that nothing beyond its citation is required.

The contention that, in the public interest, the business is one requiring regulation, need not be challenged. But Congress thus far has not seen fit to regulate it, *and its silence, where it has the sole power to speak, is equivalent to a declaration that that particular commerce shall be free from regulation.*"

Our contention is that Congress having the sole right to act, and not having acted, its silence is equivalent to a declaration that existing pipe line interstate rates are reasonable and require no regulation and that the State has no more right to attempt to interpose its judgment as to what such rates should be or to attempt to determine the actual cost of gas at any particular city gate than if Congress had, in fact, acted and the rate had actually been fixed by the Interstate Commerce Commission or some other body having jurisdiction.

If the Interstate Commerce Commission in fact had jurisdiction and in fact had established the forty-cent (40c) city gate rate the courts would, of course, be bound to accept that rate as a starting point in the determination of just rates for distributing companies and the Kansas Commission would also be likewise bound. If a rate so established could not be questioned neither can the Commission, with Congress remaining silent, contend that it should have acted and that, in its absence, the Commission will take unto itself the authority not so exercised.

As stated in the decision above quoted, the dividing line between interstate and intrastate commerce cannot be affected by common ownership of both the transportation and distribution companies and neither can the principle so often declared by this Court that the rates of transportation companies in interstate commerce cannot be regulated by the State, be changed by any such consideration. As we have before stated, at the time the forty-cent (40c) city gate rate was established by the Kansas Commission there was no affiliation of transportation and distribution properties; they were not only separate, but antagonistic. The pipe line company, and some of the distributing companies having become affiliated, by reason of the economic necessity hereinbefore recited, the applicable principles of law cannot be thereby changed. We do not believe the Commission would now undertake, in a rate case brought by the companies owning the properties at Lawrence, Atchison, Leavenworth and other Kansas cities, to dictate to those companies the price that would be allowed in their operating expenses for gas purchased from the Cities Service Gas Company, the Commission knowing that such companies were not affiliated and had no possible control over the price they were paying. Could the situation possibly change by reason of the purchase of one or all of these companies by Cities Service Company? We most earnestly contend it could not.

If the Smith case is construed as contended for by the state it will permit to be done indirectly that which this Court has repeatedly held cannot be done directly.

That the business of transporting gas as it is transported by the Cities Service Gas Company is interstate commerce and that the Kansas Commission cannot regulate its city gate rates has twice been declared by this

Court. No question of applicability of a decision exists. The cases are in regard to this particular pipe line and this particular Commission.

Public Service Commission v. *Landon,* 249 U. S. 236.
Missouri v. *Kansas Natural Gas Company,* 265 U. S. 298.

The decisions in both of these cases have been reaffirmed by this Court since the decision in the Smith case.

East Ohio Gas Company v. *Tax Commission,* 283 U. S. 465.

The Commission itself will, we think, readily admit that it cannot proceed against the supply company and fix its rates. What then does the Commission now propose to do? Why does it want to find the cost of gas at the city gate? It does not attempt to conceal its purpose. On page 26 of its brief below its counsel state:

> "If an affiliated or holding company is being unjustly enriched by charges made to a subsidiary company (gate rate) the excess charges must be deducted from the expense items. * * * To allow it to exact from the subsidiary company an excessive charge for services rendered without taking such excessive charges into account in determining a proper rate (limiting the allowance to a gate rate fixed by the Commission) would destroy any attempt at regulation."

And again on page 18 where the Commission's attorneys attempt to justify its broken promise:

> "At that time the court had held that the Commission could not go into the pipe line valuation and

into the books of the holding company *and it was reasonably felt by the Commission and by its attorneys that they could not reach the pipe line company rate and that there was no way in which an unreasonable charge by the pipe line company could be avoided.*"

The intent of all this is that the Commission proposes to use the Smith case as its authority to regulate the very city gate rate which this court twice said it could not regulate. Truly it does not propose to do so in a proceeding against the pipe line and will now admit that it cannot do so. It will say, however, that it can do so in a proceeding against the distributing company. But by what trick of logic can it with one breath say the companies are different, and with the next base its entire case on the theory that by reason of their affiliation they are one?

To be entirely frank, the Commission must admit that it is attempting to do indirectly that which it cannot do directly. If the Smith case is to be so construed the prior cases which we have cited are in effect disaffirmed and a situation arises where a pipe line system, such as that of the Cities Service Gas Co., can sell its gas to a company not affiliated free from regulation, but if it chances to be affiliated with the distribution company in the next town, the State can tell such distribution company the price it can pay. Yet in each case the commerce is interstate.

It seems to us that a mere statement of the law independent of the Smith decision and a statement of the effect of that decision as contended for by the Commission is sufficient to overthrow the contention.

In our discussion up to this point we have urged our contention that the Smith decision did not change the

law as it previously existed or place any obligation upon a distributing company to show the reasonableness of the price it is paying to another company for gas at the city gate, whether such company be affiliated or not, it being our contention that whether such price is reasonable or otherwise is a matter within the exclusive jurisdiction of Congress which alone has the power to provide the machinery for determining the reasonableness or unreasonableness of such rate. In the course of this discussion we have called the attention of the court to the fact that notwithstanding the decisions of this court, prior to the decision in the Smith case, all to the effect that the state cannot regulate the price at which gas is sold by a company engaged in interstate commerce, we have, in two previous proceedings, and in order to satisfy public criticism, submitted to that issue being determined by the state courts of Kansas and by the District Court of the United States for the District of Kansas. In both of these cases the rate was found reasonable. The Kansas Supreme Court, in the case of *Wichita* v. *Public Service Commission*, 126 Kansas 220, 268 Pacific 111, decided June 9th, 1928, said:

> "The Wichita Gas Company buys its gas of the Empire Natural Gas Company, which owns the pipe line bringing the gas from the State of Oklahoma to Kansas. The Wichita Company pays the Empire Company 40 cents per M. cubic feet at the city gate. At one time this court was of the opinion the price was subject to regulation by the Public Service Commission. *State ex rel.* v. *Gas Co.*, 111 Kan. 809, 208 P. 622. This view was corrected by the Supreme Court of the United States. *Kansas Natural Gas Co.* v. *State ex rel.*, sub nom.

Missouri v. *Kansas Gas Co.*, 265 U. S. 298, 44 S. Ct. 544, 68 L. Ed. 1027. * * *

It is impossible to declare, on the meager record in this case, either agency or abuse of corporate privilege, in the relation between the Kansas gas companies and the parent organization. The result is, the sale of gas by the pipe line company to the gas company must be regarded as an instance of ordinary bargain between seller and buyer. All of the evidence, and there was much evidence on the subject, was that no gas was available to the gas companies at a price less than 40 cents per M. cubic feet."

Judge McDermott, now circuit judge, but at the time district judge in the case of *Wichita Gas Company* v. *Public Service Commission* in the District Court of the United States for the District of Kansas, First Division, in an opinion handed down May 28, 1930 (not reported), said (R. 19):

"It seems to me that the best test of the validity of the 40-cent rate is whether gas can be can procured for less. The record shows that a competing supply line comes into Wichita. It is looking for a purchaser for its gas. If the 40-cent rate is too high, the natural thing is to turn to its competitor. For nearly four years counsel for the defendants have realized the importance of the 40-cent rate in these rate matters. Counsel for the city advises the court that for two years they have endeavored to get an offer from the competing company at a lower rate. After the hearings before the master were completed in this case, the defendants directed my attention to the testimony of some officer of the competing supply company, in another case, in which he testified the competing company could sell for less. I continued further proceedings in this

case, and gave defendants all the time they asked to bring in some written offer from the competing supply company to the plaintiff. But put to the test, the competing company would make no offer of any kind. When, after four years assiduous effort, no one can be found that will offer to supply the needs of the plaintiff for less than 40 cents, it cannot be said that plaintiff is at fault in not paying less than that for its gas.

The 40-cent rate was established many years ago; since then conditions have changed materially; apparently inexhaustible fields of gas have been discovered in Texas, but many millions have been expended in development and construction. The 40-cent rate was one of the principal controversies in the state court litigation; the situation as it existed when the matter was litigated in the state court was substantially the same as when the rate order in question was made; the Supreme Court of Kansas affirmed the finding of the trial court that the 40-cent rate should be charged as an operating expense.

The plaintiff, in fact, pays 40 cents for its gas; it is conclusively shown that no lesser rate is open to it; there is no suggestion, in the record, of collusion or fraud; the evidence shows the rate to be reasonable. Under similar circumstances, the rate has been approved by the state courts; and I find no reason for sustaining the exceptions leveled at that rate."

The decree entered by Judge McDermott in the case cited was entered in September, 1930. Originally all costs in this case were taxed to the defendants, but, upon a motion to retax, it was urged on the part of the Commission and the City of Wichita that the Wichita Gas Company had profited by having had determined the issue as to the reasonableness of the city gate rate

and other issues and that it should, therefore, share in the costs of the proceeding. This motion was sustained, a memorandum opinion being at the time filed by Judge McDermott in which is recited the agreement of the Commission to abide by the decision in that case and use it as a starting point in future rate cases (R. 19 and 48). In consideration of the agreement of the Commission to abide by this decision, Judge McDermott taxed one-third of the cost of the proceeding to the Wichita Gas Company. Within four months thereafter the El Dorado case came on to be heard before the Commission and appellant, at that time relying upon the solemn agreement of the Commission made in open court, introduced in evidence both the decision of the Supreme Court of Kansas and the decision of Judge McDermott as evidence of the reasonableness of the 40-cent price then paid by the Western Distributing Company. The Commission at the time stated that it would take notice of these decisions.

Notwithstanding these decisions and the consideration which the Commission stated it gave them, it sustained the motion of its own attorney to dismiss the proceeding, the motion being sustained entirely on the authority of the Smith case, the presiding Commissioner stating (R. 78):

> "The Commission is of the opinion that, in view of the rules laid down by the Supreme Court in the Illinois Bell case, that the motion should be granted and it is granted. The application is denied."

The court below sustained the contention of appellees, both with respect to their insistence that under the law, as announced by this court, it devolves upon any dis-

tributing company asking for an increase in rates, without regard to the size of the town, the investment in the plant or any other consideration, to show the reasonableness of the price it pays for gas at the city gate (a complete hearing as to the pipe line) and with respect to its contention that the showing actually made before the Commission by the introduction of the previous adjudications and the showing that there had been no change in the situation was not sufficient and therefore that appellant had not exhausted its administrative remedy before the Commission.

The law under which the Kansas Commission functions was enacted in 1911 and has been in force ever since. Many cases have been heard by the Commission and many proceedings have been brought in the courts to set aside orders which the Commission has made. We supposed the law to have been well settled at the time this proceeding was heard by the court below that injunction proceedings brought to test orders of the Commission were trials *de novo* in which the proceedings before the Commission were entirely immaterial except as they might reflect upon the good faith of the party asking the courts for relief. We know of no decision of the Kansas courts holding that in a proceeding such as this the court is called upon to review the sufficiency of the record made before the Commission and on the contrary insist that all of the decisions of the Supreme Court of Kansas on the subject are to the contrary. Such a decision is the case of *Railroad and Light Company* v. *Court of Industrial Relations,* 113 Kansas 217, in which that court expressly held that evidence may be introduced in court which was not introduced before the Commission and concern-

ing facts which have transpired since the Commission hearing. In this case it is said:

> "Complaint is made because the trial court considered evidence of facts and conditions arising subsequent to the date of the order. This evidence showed the phenomenal and precipitate decline in the price of fuel oil from the time of the Commission's hearing in the autumn of 1920 to the time of the trial in the District Court in the summer of 1921. In August, 1920, the price was about $2.76 per barrel; in June, 1921, it had slumped to 65 cents per barrel. Was the admission of this evidence erroneous? A lawsuit over a rate order made by the Commission is a trial *de novo*. The issue is the reasonableness of the Commission's order. Any competent evidence is admissible. It was shown that the Commission's order was largely based, not upon the showing of financial results to the power company under the contract rates during the time they had been in force or for any considerable part of that period, but upon the forecast that the temporary high rates of 1920 would continue, and upon the estimate of the Commission's engineer that the future cost of fuel oil would be $2.50 per barrel. It is doubtless and necessarily true that public utility rates must be based, in part, upon estimates of future receipts and expenditures; but when the reasonableness of those rates is drawn in question it seems only fair to test the accuracy of the basic estimates and forecasts by whatever evidence is available. We can make no better answer to defendant's contention that this evidence was inadmissible than to quote from the opinion of one of the learned trial judges in one of the present cases (Judge McClure):
>
> 'This being a trial *de novo* either party could introduce evidence not offered before the Commission, but is such evidence to be limited to condi-

tions existing prior to or at the time of the hearing before the Commission? A rate is made for the future and is based upon past, present and assumed future conditions. The past or present prices of material and labor, or other operating costs, merely furnish criterion upon which a rate-fixing body may judge of future conditions. They are only of significance as they correctly foretell the future. If, after an order is made, the uncertainty of ascertaining future operating expenses becomes certain by reason of an experience under the rates ordered, why should not the prophecy give way to certainty? It may not be proper for a court to set aside an order of the Commission upon the ground that facts and conditions subsequently arising make the order unjust, but it seems almost irrational for a court of equity to totally disregard evidence of known and definite conditions, capable of correct mathematical ascertainment, and determine the reasonableness of a rate upon speculation or conjecture as to what operating costs might be when it has available actual experience under the order. If experience shows the adequacy of a rate, should a utility be permitted to say that a court called upon to determine such adequacy should close its doors to evidence of facts definitely ascertained by experience and indulge in *a priori* reasoning, thus limiting itself to a process of speculation rather than considering the facts as they actually exist. I think the evidence was properly admitted, not as being conclusive in the premises, but as furnishing an aid to the court, together with all other evidence, in determining the reasonableness of the order when made. This rule appears to have been followed in *Northern Pacific Ry. Co.* v. *North Dakota*, 216 U. S. 579; *Knoxville* v. *Water Co.*, 212 U. S. 1, and numerous other cases, and its apparent fairness appeals to this court.'

It is argued that such evidence is only admissible where the rate complained of is one of confiscation.

We have yet to learn that an impairment of a contract right (except where justified by the police power) is not a species of confiscation (12 C. J. 929-931). * * *

The Commission may gather its facts in the most informal way, and may and should avail itself of all reports and data gathered by its own staff of engineers, statisticians, and accountants; but it is only fair that all such facts, data and reports, wheresoever gleaned, should be presented in public so that the parties to be affected by the Commission's determination may show, if they can, by cross-examination or otherwise, that such data and reports are either inaccurate, fallacious or incomplete, or not of controlling significance. In no other way can the Commission itself be sure that it is doing approximate justice to those concerned. We have said that the formalities of a judicial court need not be followed, but this is really no detriment to the parties; it facilitates the development of the facts; and it is because of the free and easy procedure permissible before the Commission that a trial *de novo,* not a mere appeal, is accorded in a judicial court from the orders of the Commission. So long as a judicial hearing *de novo* is provided, it is not very important just what sort of evidence is received by the Commission or how it is received, if the parties concerned are apprised of it. As was said in *The State ex rel.* v. *Mohler,* 98 Kan. 465, 472, 158 Pac. 408:

'If this power is abused, the courts are open to the aggrieved party, if not by some statutory review, then by the extraordinary and prerogative remedies of injunction or mandamus.'"

That such a proceeding is a trial *de novo* is recognized by Judge Hopkins (R. 56, 59), Judge Hopkins having formerly been a member of the Supreme Court of Kansas and being familiar with its decisions.

We admit the rule that parties must come into a court of equity with clean hands and are willing to admit that in proceedings before the Commission an applicant should conduct those proceedings in absolute good faith and not wilfully withhold any evidence with the idea of subsequently introducing such evidence before the court. In this proceeding, however, there is no charge of bad faith on the part of appellant and we contend not only that there can be no such charge but, on the contrary, that appellant had every reason, at the time the proceedings before the Commission were heard, to assume that the Commission would act in good faith and recognize the agreement it made of record in the United States District Court in the Wichita case and would abide by the decision of that court as to the reasonableness of the city gate rate in all future proceedings.

The situation being as we have outlined and there being no charge of bad faith or unclean hands, we believe the court below erred in refusing to consider appellant's bill and its plea of confiscation on the sole ground that appellant had failed to exhaust its administrative remedy before the Commission.

Judge Phillips, in his opinion on the motion to dismiss (R. 51-52), and in his opinion in amplification of conclusion of law No. 3 (R. 49), states that in his view of the law it was incumbent upon appellant to show that its contract with the supply company was such a one as the parties would make if dealing with each other at arms' length and in the absence of any common ownership of stock. It is our contention that we have fully complied with the views expressed by Judge Phillips in the evidence introduced before the Commission which is

recited in findings VII and XI (R. 44 and 46) to the effect that at the time the rate was established there was no affiliation of the companies by stock ownership or otherwise; that the rate had remained the same since the affiliation; that it was originally and after careful investigation established by the Commission; that no other source of supply existed; that no gas had ever been offered at a cheaper rate; than an attempt had been made to procure local gas without success; that the same rate was paid by cities in nowise affiliated, such as Lawrence, Leavenworth and Atchison, Kansas, and that there had been no material change in the situation since the decisions in the Wichita rate cases by the Supreme Court of Kansas and the United States District Court, both of which were introduced in evidence and considered by the Commission.

In our previous discussion we have given only casual consideration to the first two items enumerated in finding IX (R. 46) for the reason that both items could be eliminated without affecting the result of the proceeding. It is our contention that these items are merely items of operating expense which could be disallowed by the Commission if it determined them to be unreasonable but that they are not such matters as would justify the Commission in dismissing the proceeding and denying relief any more than such justification would exist as to any other items of operating expense with the proof of which the Commission might not be satisfied.

The reasonableness of each of these items was litigated in the Wichita rate case both in the Supreme Court of Kansas and the United States District Court. In regard to the first item the Kansas Supreme Court said:

> "Henry L. Doherty & Company maintain a corps of experts in engineering, research work, and other

activities, who render valuable services to gas companies by way of engineering advice, legal advice, accounting and auditing service and assistance in matters of finance. One and three-fourths per cent of the gross revenue of the gas company is paid to Henry L. Doherty & Company for this service. There was no testimony that the compensation was either improper or extravagant, and it was admitted that it was paid in good faith."

The United States District Court said:

"Doherty and Company are paid 1¾% of the gross receipts for certain services rendered and detailed by the master. The law is settled by the decisions of the Supreme Courts of the United States and of Kansas concerning the 4½% contract between the American Telephone and Telegraph Company and its subsidaries. The record and the master's findings bring this case within that law. It is contended that the work done by Doherty and Company duplicates the work done at Kansas City. The record is to the contrary. It is contended that the services by Doherty and Company are paid for as they are rendered, and that the 1¾% payment is profit. The record is to the contrary. In fact, the undisputed evidence shows that the 1¾% was arrived at by ascertaining the actual cost of the services rendered to all distributing companies and apportioning it according to gross sales. Furthermore, the record shows, without dispute that the necessary operating expenses are less than they would be if the Wichita plant was operated as an independent unit."

As to the second item the Supreme Court of Kansas said:

"Doherty companies in Kansas and nearby states are managed from a regional general office (Gas

Service Company at Kansas City). Other groups of Doherty companies are similarly managed. The offices of the general manager, the chief engineer, and the legal department, for this region are maintained at Kansas City, Missouri. The general ledgers of the Kansas gas companies are kept there. All general office expense, executive salaries, general clerical salaries, legal expense, and general traveling expense, are borne by the Kansas City office, and the proper sum is charged to each gas company. The referee found on abundant evidence that the sums paid by the three Kansas companies were reasonable and proper, and allowed them."

The United States District Court said:

"Certain of the company's necessary work is done from Kansas City by the Gas Service Company, which does the same work for a number of other distributing companies. The method should make for economy; the expenditures are conceded. It is claimed that all of these expenses should be disregarded, because some charitable contributions enter into them. The evidence discloses that such contributions are negligible, and the amount prorated to Wichita so small that their elimination would have no bearing on the result."

The adjudication of both these matters was included in the agreement hereinbefore referred to wherein the Commission stated that if part of the costs were taxed to the Wichita Gas Company it would abide by Judge McDermott's decision and use it as a starting point in future rate cases.

We believe the Commission would have recognized its agreement in the instant case had it not been for the

Smith decision, on the authority of which the contention was made that it was not sufficient to show, as had previously been shown, that the expense of Henry L. Doherty & Company, without profit, was allocated to the companies receiving its service on a gross revenue basis and that the expense of The Gas Service Company, without profit, was allocated to the companies receiving its services on a meter basis but that on the authority of the Smith case it was necessary to show the actual services rendered by each of these organizations to any particular property and the cost to such organization of rendering such service. The applicant declined to make such a showing because of its impossibility and because of its contention that the Smith case could not be construed as requiring such a showing. As above stated, it had been shown in previous cases that both the New York organization and the Kansas City organization operated without profit and were maintained solely for the benefit of the companies receiving their respective services and that their actual expenses only were allocated to the respective properties receiving such service. The Smith case involved an allocation of expense between interstate and intrastate business, the necessity for which is absent in the instant case, and also involved inter-company relations which were carried on for profit, the reasonableness of which profit was brought in question.

The showing made by the Western Distributing Company before the Kansas Commission consisted of its own undisputed evidence to the effect that it was operating under rates established by the Commission in 1920; that the present fair value of its property was the sum of $288,442.00; that for the year ending November 30,

1930, its gross earnings were the sum of $197,394.64 with actual expenses of $283,049.07, leaving a deficit of $40,654.42 in which sum it failed to make its actual and necessary operating expenses. The court below, while not finding the amount in which appellant failed to make its operating expenses, did find, in finding No. X (R. 46) that the items of expense representing payments to Henry L. Doherty & Company and the Gas Service Company could be eliminated and that applicant would still fail to make its operating expenses by an amount greatly in excess of the total of said items, such total being $9,424.54.

There can, therefore, be no question of insufficient returns and resulting confiscation nor any contention that appellant was not entitled to relief from the court below except on the ground that it failed to make a showing as to the reasonableness of the price it was paying an affiliated company engaged in interstate commerce for gas at the city gate in addition to the showing which it did make and which appellant now contends was sufficient to establish a *prima facie* case.

We respectfully submit that as a matter of law the Kansas Commission had no authority to investigate the reasonableness of the price charged by the Cities Service Gas Company, engaged in interstate commerce; that appellant was not required to make any showing before it as to the reasonableness of that price; that the Smith case has no application to the facts of this case; that appellant conducted its proceedings before the Kansas Commission in absolute good faith and that the court below erred in its conclusion that appellant had not exhausted its administrative remedy before the Commission; in

denying appellant's application for a preliminary injunction; in dismissing the bill and denying the relief sought therein.

ROBERT D. GARVER,
Kansas City, Missouri,
ROBERT STONE,
Topeka, Kansas,
Solicitors for Appellant

FILE COPY

No. 36151.

FILED
JAN 8 1
CHARLES ELMORE

THE SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1931.

No. 337.

WESTERN DISTRIBUTING COMPANY,
APPELLANT,

vs.

THE PUBLIC SERVICE COMMISSION OF THE STATE OF KANSAS, ET AL.,
APPELLEES.

APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE DISTRICT OF KANSAS.

BRIEF ON BEHALF OF APPELLEES.

CHARLES W. STEIGER,
Topeka, Kansas,
EARL H. HATCHER,
Topeka, Kansas,
Solicitors for Appellees.

KELLEY BRIEF PTG. CO. TOPEKA

INDEX.

	Page
ARGUMENT	12
ASSIGNMENT OF ERROR No. IV	59
CONCLUSION	60
HISTORY OF PROCEEDINGS	4
OPINIONS OF THE COURT BELOW	1
STATEMENT OF THE CASE	1
SUMMARY OF ARGUMENT	10
THE ISSUE OF FACT	13
Was the evidence sufficient to enable the Public Service Commission to make a finding as to the reasonableness of the contracts under which services were rendered and gas furnished by holding and affiliated companies	16
The Doherty 1¾% Charge	16
The Gas Service Company Managerial Charge	20
The Cities Service Gas Company's Gas Purchase Charge	21
Allegations in Paragraph XIII of Answer	25
THE ISSUE OF LAW	32
1. The utility must exhaust its remedy before the Commission before seeking injunctive relief	33
2. A utility has not exhausted its remedy before the Commission until it has produced evidence upon which findings can be made upon all material issues affecting the rates	39
3. The cost of service rendered and gas furnished by a holding or affiliated company is a material issue to be determined in a rate case as a test of the reasonableness of the contracts	47

TABLE OF CASES CITED.

Page

Backus-Brooks Co. v. Northern Pac. Ry. Co., 21 Fed. (2) 4 Syl. 17 .. 33

Cincinnati N. O. & T. P. R. Co. v. Interstate Commerce Commission, 162 U. S. 184, 40 L. Ed. 935 37-45
Chicago & G. T. Ry. Co. v. Wellman, 143 U. S. 338, 36 L. Ed. 176 .. 38
Chicago, Burlington & Quincy R. Co. v. Winnett, 162 Fed. 242 33

Great Northern R. Co. v. Merchants Elevator Co., 259 U. S. 285, 291, 66 L. Ed. 943, 946 35

Henderson Water Co. v. Corporation Commission, 269 U. S. 277, 70 L. Ed. 273 33
Houston v. S. W. Bell Tel. Co., 259 U. S. 318 8-10-48

Lawrence v. St. Louis-San Francisco Ry Co., 274 U. S. 588, 71 L. Ed. 1219 34

National Gas Co. v. Public Service Commission, (W. Va.) 121 S. E. 176 42

Oregon Short Line R. Co. v. Teton Coal Co., 35 F. (2d) 919, Syl. 9 .. 34

Pennsylvania Gas Co. v. Public Service Commission, 252 U. S. 23 50

St. Louis-San Francisco Ry. Co. v. Alabama Public Service Commission, 279 U. S. 843, 73 L. Ed. 560 34
Simpson v. Shepard, 230 U. S. 352, 419, 57 L. Ed. 1511, 1550 35
Smith, v. Ill. Bell Telephone Co., 282 U. S. 133, 75 L. Ed. 99 .. 7-14-48-53
S. W. Bell Tel. Co. v. Public Service Com., 262 U. S. 276 8-10-48

United Field Gas Co. v. Railroad Commission, 278 U. S. 300 8-10-48

Vincennes Water Supply Co. v. Public Service Commission, 34 Fed. (2d) 5 34

Western & Atlantic R. v. Georgia Public Service Commission, 267 U. S. 492, 69 L. Ed. 753 34
Wichita R. R. & L. Co. v. Public Utilities Commission, 260 U. S. 47, 67 L. Ed. 124 44

The Supreme Court of the United States

OCTOBER TERM, 1931.

No. 337.

WESTERN DISTRIBUTING COMPANY,
APPELLANT,

vs.

THE PUBLIC SERVICE COMMISSION OF THE STATE OF KANSAS, ET AL.,
APPELLEES.

BRIEF ON BEHALF OF APPELLEES.

OPINIONS OF THE COURT BELOW.

The opinions of the Court below were not reported but appear in the record of this proceeding on pages 49, 50, 53 and 56, with the decree at page 42, and an opinion overruling the first motion to dismiss at page 8.

STATEMENT OF THE CASE.

The appeal is from an order and decree (R. 42) of a duly constituted three-judge statutory Court for the District of Kansas, consisting of Orie L. Phillips, C. J., J. Foster Symes, D. J., and Richard J. Hopkins, D. J. The decree denied the application of the appellant for

a temporary injunction and dismissed the cause. The matter was submitted upon the issues joined by the amended bill of complaint (R. 12) and the answer thereto (R. 27).

The appellant, the Western Distributing Company, by its amended bill of complaint, pray that the Public Service Commission for the State of Kansas be enjoined from enforcing the rate now on file for the City of El Dorado, and from interfering with the plaintiff, putting into effect a new rate. The appellant also asks for a temporary injunction pending the final determination of the suit (R. 2).

The appellees, by their answer, challenged the right of appellant to seek relief in a court of equity on the grounds the action was premature, the appellant having failed to exhaust its remedies before the Public Service Commission. The appellees based their allegation of appellant's failure to exhaust its remedy before the Public Service Commission on its failure and refusal to produce for the Commission evidence of the cost of service, and rate of return earned by holding and affiliated companies in justification of the reasonableness of the contracts. Payment for these alleged services and gas furnished by holding and affiliated companies made up a large part of the expense of appellant's plant at El Dorado.

The hearing on the preliminary issue raised by appellee's answer was heard on June 25, 1931. The evidence consisted of a stipulation as to the evidence introduced before the Commission respecting the holding or

affiliating company charges and certain affidavits filed by appellants (R. 62-89).

The motion to dismiss the appellant's bill of complaint as set out in appellee's answer was argued, and the court sustained the motion (R. 42), made findings of fact (R. 43) and conclusions of law (R. 48).

HISTORY OF PROCEEDINGS.

On pages 3 to 20 of its Brief, appellant sets out what it terms a brief outline of the situation which existed at the time of the hearing.

Pages 3 to 10 sets out the early history of the pipe line company and reviews certain litigation in which the company was involved. Although this may be of some historical interest, it has no bearing upon the present case. The matters there set out were not before the Commission and were not presented to the court from which this appeal is taken. At the time the 40¢ rate was established for the gas pipe line company, it was represented that the gas supply was limited, and that rate was allowed for the purpose of conserving gas and amortizing pipe lines over a short period. It very quickly developed that the supply of gas was practically unlimited and that the basis upon which the 40¢ rate was established was erroneous, and the Commission set aside the order on December 20, 1924. Findings VII (R. 44).

On pages 7 and 8 of its brief, appellant lays considerable stress on a case filed by the Wichita Gas Company in the District Court of United States for the District of Kansas and takes issue with the failure of the Com-

mission to consider this matter as a binding adjudication as to reasonableness of the pipe line rate. The remarks there set out without explanation might lead to the opinion that the Commission is not willing to follow the decision of the Court. The Commission feels that it has a duty to perform both to the utility and the public in general. Its only attempt has been to determine the reasonableness of the pipe line rate and protect the utility from unjust criticism, or if the rate is unreasonable to have the matter settled out of fairness to the public. We submit that in none of the cases mentioned by the appellant has there been a proper determination of the pipe line company's rate or the holding company service charges.

The extent of the investigation into the pipeline rate in the Wichita Gas case was referred to in the hearing before the Commission and set out on page 66 of the record, as follows:

> "In response to an inquiry by Mr. Montgomery, then a member of the Commission, it was stated that the only valuation introduced was a general estimate by Mr. Hamilton, chief Engineer of Henry L. Doherty & Company, which was a general estimate in round figures. No exhibit was introduced, but his testimony occupied a day or two. It was stated by counsel for the applicant that no valuation, to his knowledge, had been made of the pipe line system; that he had been informed that it would cost $50,000.00 to $100,000.00 to make it."

This clearly indicates that there was no proper determination of the reasonableness of the pipeline rate charged to the affiliated distributing company.

It is admitted that the decisions of the State Courts and of the Federal Courts were introduced in the hearing before the Commission and that the Commission stated it would take notice of them, but the record of these cases was not introduced. The appellant did move to reopen the hearing before the Commission and introduced a complete transcript of the record in the Federal Court in the case of the Wichita Gas Company vs. The Public Service Commission (R. 78). The Commission's attorney then asked for time to familiarize himself with the record before it was introduced. Counsel for the appellant then stated: "I withdraw the motion. I would rather get it started in the courts and find out what the law is now." (R. 80.) This statement clearly shows that it was not the intention of the appellant to produce evidence of the reasonableness of the contracts between the affiliated companies and their desire to have the question determined as to whether or not such a showing had to be made.

On page 10 of its brief, plaintiff says that it appeared before the Commission believing that it would not be required to again litigate the question of the rates of the pipe line company. It was notified upon the first day of the hearing that evidence upon these items was necessary and it had two weeks in which to meet the requirement. Considerable emphasis is placed upon some statement made by an attorney in a previous case that the Commission would take the 40¢ rate as a starting point for future rate cases. If such a statement was made, it was made by a party not now connected with

the Public Service Commission and under a Commission not now in the office. It is elementary law that one public officer cannot by a statement bind a successor in office. We would, however, feel under obligation to follow any such suggestion when made, if conditions were not changed, if the courts had not since that time presented a theory of law which is different from the theories held by both parties with reference to the then existing law, and if the record did not disclose that a proper showing was not made at that time.

In the hearing now in controversy, the Commission was simply attempting to follow the law as laid down by the recent decision by the United States Supreme Court and its previous decisions requiring a public utility to justify the reasonableness of contract made with holding or affiliated companies.

The shifting contentions of appellant are indicative of the doubtful manner in which the reasonableness of the contracts between the distributing company and the holding or affiliated company was presented to the Commission.

In the hearing before the Public Service Commission the plaintiff took the position that the case of Smith v. Illinois Bell Telephone Company, 282 U. S. 133, was not applicable, and refused to submit evidence on the holding company charges which made up the major portion of the expense of the distributing company. The attorney for the Western Distributing Company stated to the Commission:

"If the Commission please, I am familiar with the decision of the Supreme Court of the United States in the Illinois case. I do not think it has any application, and I do not intend to argue it." (R. 77.)

Assuming that the appellant would stand upon this theory, the Public Service Commission filed a motion to dismiss the bill of complaint filed in the Federal Court on the ground that appellant had failed to exhaust its remedy before the Public Service Commission. When this issue was raised, the plaintiff changed its theory, and amended its bill of complaint, at the court's suggestion, to come within the rule laid down in Smith v. Illinois Bell Tel. Co. case.

Counsel for appellant at that time stated to the court:

"We stand ready, your honors, and we expect to introduce here the full valuation of the pipe-line company. We expect to go into these things and we expect to comply with the rules laid down in the Bell Telephone case as far—and to allocate all these things as far as possible to the El Dorado distributing company. We stand ready to do that."

The court then instructed the parties to abstract the record of the proceedings before the Public Service Commission and to file briefs on the question as to whether or not the appellant had made a sufficient showing on the holding company charges to exhaust its relief before the Public Service Commission. Believing that the appellant would stand on this theory, the appellees abstracted the record and submitted their brief showing that such proof was not made. The appellant again entirely reversed its position. It is now again contend-

expense. This is in conformity with the rule announced in Houston v. Illinois Bell Telephone Company, 259 U. S. 318; S. W. Bell Telephone Co. v. The Public Service Commission, 262 U. S. 276; and United Fuel Gas Company v. R. R. Commission, 278 U. S. 300.

The decision of the lower court, from which this appeal is taken, was limited to that extent. In its opinion the lower court said:

> "It is my opinion that the Commission in making inquiry into the city gate rate, should not approach that question as it would were it empowered to fix such rate, the inquiry should be for the purpose of determining whether the contract between the plaintiff and the Cities Service Gas Company, an affiliated corporation, is fair and reasonable, and such as prudent business men acting in good faith and in the exercise of a sound discretion would have entered into under similar circumstances." (R. 52)

This statement is in conformity with the previous decisions of the U. S. Supreme Court and justified the dismissal of the Bill of Complaint on that ground. It is our judgment, however, that in view of the decision in the case of Smith vs. Illinois Bell Telephone Company, 282 U. S. 133, the statement does not go far enough. In addition to using the cost of rendering the service and the rate of return earned as one of the elements in measuring the reasonableness of the contract, the cost of rendering the services and the rate of return earned should be the full measure of the reasonableness of the contract, and should determine what amount should be allocated in this respect to the operating expense of the distribution company.

It is also the contention of the appellees that the same measure should be used in determining the reasonableness of the contract between the Gas Service Company, a holding company of the Western Distributing Company, and the distributing company for services rendered, and the same measure should determine the reasonableness of the contract by which the distributing company pays to Henry L. Doherty & Company one and three-fourths per cent of its gross earnings.

ARGUMENT.

The matter is now before the Court on two major issues—

1. The issue of fact.

Is the evidence sufficient to make a prima facie showing of the reasonableness of the contracts under which service is rendered and gas furnished by the holding and affiliated companies?

2. The issue of law.

Must a public utility introduce evidence before the Public Service Commission upon which it can make findings as to the reasonableness of contracts under which services are rendered and gas furnished by holding and affiliated companies?

THE ISSUE OF FACT.

The undisputed facts in so far as they are material to the issue are as follows:

> "On July 29, 1929, the Western Distributing Company filed its applications with the Public Service Commission of the State of Kansas for increase in rates charged for natural gas in twenty-two cities and towns including El Dorado, Kansas. The applications were set for hearing but continued from time to time on the request of the applicant to enable the engineers to prepare inventories and appraisals. On January 7, 1931, the applications were again set for hearing and counsel for the applicant stated it was prepared only on the El Dorado case at that time. Hearings on the El Dorado application were heard on January 7, 8 and 21. The undisputed evidence of the applicant disclosed:
>
> "1. The applicant, the Western Distributing Company, is a corporation engaged in the business of a public utility furnishing natural gas to consumers in the city of El Dorado, Kansas.
>
> "2. Its capital stock is owned by the Gas Service Company, a corporation, a holding company owning, through stock ownership, and operating many public utilities, in Kansas, Missouri and Oklahoma.
>
> "3. The capital stock of the Gas Service Company is owned by the Cities Service Company, a corporation holding the capital stock of several hundred public utilities throughout the United States.
>
> "4. The capital stock of the Cities Service Gas Company is owned by the Empire Gas and Fuel Company, a corporation.
>
> "5. The capital stock of the Empire Gas and Fuel Company is owned by the Cities Service Company.
>
> "6. The Cities Service Company is the common

owner of the companies recited above and the companies are mere agencies and instrumentalities of it.

"7. Henry L. Doherty, doing business as Henry L. Doherty & Company, through agency contracts, manages and controls the operations of all these companies, both in their relations with the public and between themselves.

"The evidence also disclosed:

"1. The Western Distributing Company pays 1¾ per cent of its gross revenue to Henry L. Doherty & Company. This payment in the amount of $3,454.43 was included in the items of expense for the El Dorado plant.

"2. The Gas Service Company operates and manages the Western Distributing Company and keeps the books of the Western Distributing Company in Kansas City, Missouri, and charges to the Western Distributing Company certain sums annually, purporting to be the Western Distributing Company's share of expense of the Gas Service Company. These charges, amounting to $5,970.11, were included in the items of expense for the El Dorado plant; also unclassified expense amounting to $4,667.91.

"3. The Western Distributing Company buys its supply of natural gas from the Cities Service Gas Company. There was included in the items of expense for the El Dorado plant the sum of $176,260.32 paid to the Cities Service Gas Company for gas purchased." (R. 62, 63)

It is admitted by the appellees that the appellant produced sufficient evidence to make a *prima facie* showing upon all issues except the cost of services rendered and gas furnished and rate of return earned by the holding or affiliated companies. After the Western Distributing Company rested its case the attorney for the Public

Service Commission moved that the application be denied, alleging in substance that:

1. Under the decision in the case of *Smith v. Illinois Bell Telephone Company*, 75 L. Ed. 99, it was necessary for the Commission to make findings as to the cost of services rendered and rate of return earned by the holding or affiliated companies, and that it was incumbent upon the applicant to produce evidence upon which such findings could be made.

2. The applicant failed and refused to produce for the Commission evidence showing the cost to the above-mentioned affiliated companies in rendering services and furnishing gas; and produced no evidence as to the value of the services. On request of the Commission the witnesses for the applicant refused to produce evidence on any of these items, although one of the witnesses admitted such information was in his possession. His refusal to make such disclosures was done on advice of counsel.

3. The Western Distributing Company, through its owner, the Cities Service Company, and by reason of its management and control by Henry L. Doherty & Company, had in its possession and could have produced, or caused to be produced, before the Public Service Commission, testimony showing the reasonable and fair cost of gas delivered by the affiliated company to the applicant.

4. The Western Distributing Company, through its officers and employees, who are also officers and employees of the Gas Service Company, have in their possession and control books and records and other evidence show-

ing the kind and amount of the expenditures of the Gas Service Company, but they failed to produce such evidence and refused to produce it or make such data available to the Public Service Commission.

5. The Western Distributing Company failed and refused to produce any evidence of the services rendered by Henry L. Doherty and Company in consideration of the 1¾ per cent payment, or of the cost of rendering the service. (R. 74-77)

The attorney for the applicant argued that the Illinois Bell case, *supra*, was not applicable. (R. 77)

The Commission, after taking a ten-minute recess, denied the application on the motion of its attorney.

The attorney for the applicant then asked permission to reopen the case and introduce the record of the Wichita gas case tried in the Federal Court. (R. 78)

The Commission then granted the request, but was continuing the case to give its attorney time to examine the record, when the attorney for the applicant said: "I will withdraw the motion. I would rather get it started in the courts and find out what the law is now." (R. 80)

Was the evidence sufficient to enable the Public Service Commission to make a finding as to the reasonableness of the contracts under which services were rendered and gas furnished by holding and affiliated companies?

A condensed statement has been prepared which sets out the evidence before the Public Service Commission on these issues.

Some evidence will be found elicited, however, on cross

examination, that the services were worth to the distributing company what it paid for them, and that gas could not be procured for less. This evidence throws no light upon the issue. The Commission must determine what it costs the parent company to render the service and whether or not it is earning more than a reasonable return.

There are three such expense items at issue in the present appeal:

1. The 1¾ per cent gross revenue charge, paid to Henry L. Doherty & Company. This payment amounted to $3,454.43.
2. The Gas Service Company's managerial charge amounting to $10,638.02.
3. The purchase of natural gas from the Cities Service Gas Company amounted to $176,260.32.

The amount paid to the holding or affiliated companies totaled $190,352.77. This was the major part of the expense of the Distributing Company.

They shall be discussed in order in which they appear, as to the sufficiency of the showing of cost of service and rate of return to the holding or affiliated company, and the reasonableness of the contracts.

I.

The Doherty 1¾% Charge.

The appellant offered in evidence before the Commission the decisions of the Federal Court and of the Kansas court in support of this charge. The Commission stated that it would take notice of the decisions. (R. 64)

It is understood, of course, that the Commission must take notice of the decisions of the courts as to the law involved, but these decisions throw no light upon the cost to Henry L. Doherty & Company to render the service for which he was paid 1¾ per cent of the gross revenue, nor of the rate of return earned by him.

Mr. Rice, called as a witness for the applicant, testified that this 1¾ per cent charge was fixed by Henry L. Doherty; he also testified that the service which Henry L. Doherty was to perform was in a proposal accepted by the Distributing Company's board of directors. (R. 65)

When questioned about the 1¾ per cent Mr. Rice testified:

> "I know generally about it, but nothing specific.
>
> "Q. What services have been furnished by Henry L. Doherty & Company under this contract? A. I could not tell you just offhand.
>
> "Q. Well, would your office have any accounts at all of any value received under this proposal from Henry L. Doherty & Company? A. As to specific entries, I would not have them.
>
> "Q. Will you state as a matter of fact that they do not have any record? A. No. I don't know that." (Summarized R. 65)

As this witness, who was the accounting engineer, knew nothing specific about the services performed—did not even know whether there was a record of any services performed—it would be useless to peruse his testimony further.

Mr. Adams, vice president and manager of the Gas Service Company, and president of the Western Distributing Company, was the only other witness to testify. He did testify that in his judgment the services were worth to the Distributing Company the price that was paid for them. (R. 69)

This testimony, however, is not evidence of the actual test in the case—that is, what it cost Henry L. Doherty to furnish the service and what his earnings were. No other testimony can be found in the record pertaining to the cost of rendering the service by Henry L. Doherty & Company. Mr. Adams did, on the advice of counsel, refuse to submit such evidence. (R. 71)

Mr. Adams refused to give access to the books so that the Commission could determine the actual expenditure made by the company in performing these services. "A. As I say I am guided by advice of counsel on that."

The advice of counsel was that the courts had held it was not necessary for the Commission to have the books: "The attorneys will tell you now—no." (R. 71)

This certainly is not evidence upon which the Commission could make a finding as required by law as to the 1¾ per cent charge. The testimony as set out also exposes the contention of the plaintiff that it was surprised when the Commission entertained a motion to deny the application for lack of evidence to enable it to make a finding on this item.

II.

The Gas Service Company Managerial Charge.

Mr. Rice was first questioned as to this charge:

> "Q. Can you state what the services were? A. Yes. We furnished all administrative and executive service, financial aid and advice, general purchasing and warehousing operations are handled by the Gas Service Company.
>
> "Q. You are reading from the contract what they will do if requested? A. I am reading from what they actually do handle, all general engineering, and operating supervision, all legal services, all insurance purchases; all general accounting is done by the Gas Service Company, they have supervision and handling of all tax matters, handle all pay rolls, they make all audits and audit reports." (R. 66)

The above information was given by Mr. Rice on cross examination. He gave no further testimony on the managerial charge. This testimony was given from a memoranda of what the Gas Service Company contracted to perform. There is no testimony as to what services were actually performed nor the cost thereof.

No exhibit was prepared showing the total expense of the Gas Service Company.

Mr. Adams gave no testimony as to the cost of rendering these services or the value thereof. He did testify that he had access to the books of the Gas Service Company which contained the information requested by the Commission. He was then asked:

> "Q. Will you produce that information? A. I will be guided by the advice of attorneys." (R. 71)

ing that the Smith case is not applicable, and that a showing as to these items is not necessary. In its brief in the lower court, appellant stated:

> "No clearer cut issue than this could exist, as the motion was on one ground. The ruling was on one ground. The correctness of that ruling is the one issue before this court. If the Smith case does apply and if as stated by the Commission's attorney (Abs. 23) 'The Supreme Court in speaking through its chief justice, has apparently, using the common every-day language, made a new law,' then the motion was properly sustained."

It is not the theory of the appellees that any new law was necessary to support the ruling of the Commission and that of the Federal District Court. Decisions previous to that of the Smith vs. Bell Telephone Company, 282 U. S. 133, had laid down the rule that the Commission might inquire into reasonableness of charges made by holding or affiliated companies for the purpose of fixing the local rates of an operating unit. (Houston vs. Southwestern Bell Tel. Co., 259 U. S. 318; Southwestern Bell Tel. Co. vs. Public Service Commission, 262 U. S. 276; United Field Gas Co. vs. Railroad Commission, 278 U. S. 300.)

This matter is now of great importance to the State of Kansas in view of the fact that the pipe line company supplies gas to approximately 100 distributing plants in Kansas which serve the important cities of the state, and the regulations of rates of these distributing plants is impossible, if the pipe line company is in position to exact any charge that it sees fit without regu-

lation, in view of the fact that all of the companies are responsible to their holding company, the Cities Service Company and the earnings of both companies are received by it.

SUMMARY OF ARGUMENT.

1. It is the contention of appellees that a utility must exhaust its remedy before the Commission before seeking injunctive relief.

2. That a utility has not exhausted its remedy before the Commission until it has produced evidence upon which findings can be made upon all material issues affecting the rate, including the cost of services rendered and gas furnished by a holding or affiliated company and set up as expense items.

3. That the cost of services rendered and for gas furnished by holding and affiliated companies is a material issue to be determined by the Commission in measuring the reasonableness of the contracts.

It is not our contention that the Public Service Commission has authority to fix a rate for which gas shall be sold by an interstate pipe line company. It is our contention, however, that where the pipe line company is affiliated with the distributing company by reason of the capital stock of the pipe line company and the distributing company being owned by a common holding company, that the Commission can inquire into the reasonableness of the charge made by the pipe line company for the purpose of determining whether or not the charge is unreasonable and reflects an unreasonably high operating

The attorneys advice was "no." (R. 71)

The record contains no evidence of what services were rendered, if any, and what the cost of the services was.

III.

The Cities Service Gas Company's Gas Purchase Charge.

Considerable effort was made by the Commission to obtain information as to the cost to the Cities Service Gas Company in furnishing gas and the rate of return earned, because of the size of this expense item and the effect it had upon the rate. The record, therefore, has considerable testimony referring to this item, but it will be found absolutely void of any testimony as to the cost of furnishing the gas and the rate of return earned.

The former decisions of the Kansas Supreme Court and of the Federal Court were introduced. The record in these decisions was not introduced, however. The Commission is ready to admit that it must take notice of the decision; however, there is no evidence in those decisions on the issue now before the court. Those decisions are not *res adjudicata*. The present record contains testimony as to the limited extent to which the matter was gone into in the cases cited. (R. 66) In view of the fact that the decisions are not *res adjudicata* the absence of sufficient evidence to enable the courts to make an intelligent finding upon these issues need not be discussed.

Evidence was introduced to the effect that the gas could not be purchased cheaper and that there was no other source of supply. This testimony, however, throws

no light upon the question as to what it costs to furnish this supply and the rate of return earned. Because of the peculiar conditions surrounding gas service it would, of course, be impossible to get any company to parallel the present pipe line into the city of El Dorado. It is even possible that the pipe-line company could charge a much higher rate than it is now charging and still not be troubled with competitive pipe lines. Such a charge, however, would be unreasonable and the rate of return could not be justified.

Mr. Rice testified that he had no information in regard to pipe line matters other than what he heard in the Wichita rate case and had made no study of what it cost the pipe line company to deliver gas. (R. 66)

Commissioner Montgomery then read from the recent decision in the Illinois Bell case showing the necessity of findings upon this point and asked if the accountants for the applicant had given the matter consideration and if he had prepared exhibits along that line. The witness replied that he had not. This happened upon the first day of the hearing and the case was later adjourned for two weeks. Certainly the appellant cannot contend that it did not have warning that the Commission would require such evidence and did not have an opportunity to prepare it. The Commission not only requested such information, but read from the decision which made the evidence mandatory. (R. 67)

Mr. Adams testified that his only knowledge came from testimony submitted in the Wichita case and what he had been told about the earnings of the company and its in-

vestments. He did not seem, however, to be quite clear on the matter, as he testified: "It seems to me there was some testimony of that character, covering cost of delivering gas exclusive of all overheads." He also testified that he and his board of directors had made no investigation as to the reasonableness of the 40-cent charge other than what he had heard. "My theory about the price that the Distributing Company pays for gas is this. We are less interested in the price we pay for gas than we are in the ability of the company to deliver us gas at all times during the peak load and during the loads that are less than those loads during peak hours." (R. 70)

This factor may not be of very much importance to the Distributing Company, but it certainly is an important factor to be considered by the Commission in determining the reasonableness of the rate, in view of the fact that the earnings of both the Distributing Company and the pipe-line company are received by the same company.

The attitude of the appellant as to the insufficiency of the evidence to show the cost of supplying gas and the rate of return earned by the pipe-line company is indicated by its attitude following the denial of the application.

The attorney for the Public Service Commission moved to have the Commission deny the application. He quoted from the Illinois Bell Telephone case, and cited the necessity of the Commission making findings upon the issues now in controversy. (R. 75)

The attorney for the appellant then stated:

> "If the Commission please, I am familiar with the decision of the Supreme Court of the United States in the Illinois Bell case. I do not think that it has any application and I do not intend to argue it. It is immaterial whether it is applicable or whether it is not. *** Well, I don't think the rule is applicable because your telephone companies are engaged in interstate business. They have their interstate calls as well as their local calls." (R. 77)

After the Commission denied the application because of the insufficiency of the evidence on the three items of expense to enable them to make a finding as to what constituted a reasonable rate, the attorney for the applicant then moved that the case be reopened and that it be permitted to introduce the complete transcript of the record in the Wichita gas case. (R. 78) The attorneys for the Public Service Commission then asked for an opportunity to examine the proceedings in the Wichita gas case. (R. 79) The Commission granted the motion to reopen, and was continuing the case to give its attorneys who were unfamiliar with the transcript an opportunity to examine the proceedings, when the attorney for the applicant stated:

> "I will withdraw the motion. I would rather get it started in the courts and find out what the law is now." (R. 80)

It therefore clearly appears that the only evidence which would have enabled the Commission to in any way make a finding upon the issue was withdrawn by the applicant to enable it to get the case into court to deter-

mine whether or not it had to submit evidence upon these issues.

Allegations in Paragraph XIII of Answer.

In view of the fact that appellant has attempted in paragraph XIII of its amended answer to allege facts which would bring it within the jurisdiction of a court of equity, and those allegations deal with the issue of fact just discussed, it may be well to take up briefly those allegations as they appear in the appellant's bill of complaint.

The amended bill of complaint is set out in the transcript of record and the beginning of paragraph XIII appears on page 18.

In paragraph XIII of this amended bill of complaint appellant states:

1. **"That plaintiff thereupon introduced evidence substantially as follows:" and the following statements appear:**

(*a*) There was no other source of supply.

(*b*) No gas had ever been offered at a cheaper rate.

(*c*) Plaintiff would purchase cheaper gas if offered by any other company.

(*d*) Cost of bringing gas to the city gate had not altered greatly for quite a few years.

(*e*) That it cost just as much now as fifteen or sixteen years ago.

(*f*) There has been no change in the city gate rate since 1923.

(*g*) In the opinion of an expert witness, 40¢ gate rate was reasonable.

(*k*) All cities on the Cities Service Gas Company system receive their supply from a common source.

(*i*) The price is the same as to all cities not having local gas.

(*j*) An effort was made to find local gas available to El Dorado, but none was found.

(*k*) The president of the Western Distributing Company had heard it was not earning a fair return.

(*l*) The 40¢ gate rate was established to encourage gas operators to go farther for an adequate supply.

(*m*) When 40¢ gate rate was established all the larger cities were not owned or associated with the Cities Service Gas Company, and that no change has been made in the city gate rate since those cities were acquired.

(*n*) The city gate rate was established by the Kansas Commission in 1923.

(*o*) There has been no change in conditions that might make the rate unreasonably low.

(*p*) The Western Distributing Company had tried to get a lower rate from the Cities Service Gas Company, but could not.

(*q*) The properties at Lawrence and other towns are owned by outside interests and pay 40¢ at the gate.

Evidence, if any of a substantial character can be found, in support of the statements set out, is immaterial and has no bearing on the question as to the cost to the pipe-line company in furnishing gas at the city gate of El Dorado and the rate of return earned. This evidence, perhaps, might have been competent under the theory that the Commission could not take into consid-

eration the cost which the Distributing Company paid for the gas at the city gate, but it is not competent and in no way tends to show what it cost the pipe-line company to render the service, and we do not believe that sufficient evidence can be found in the record to even justify the irrelevant statements set out above.

The statement, under (*k*), that the president of the Western Distributing Company had heard the pipe-line company was not earning a fair return, is hearsay and not competent evidence and furnishes no basis upon which the Commission can make a definite finding as to a reasonable rate.

2. The allegation that the Commission asked for no evidence in addition to that introduced by the appellant is without foundation and not supported by the record.

This allegation is clearly not supported by the record. While Mr. Rice was on the stand Commissioner Montgomery questioned him as to the cost of gas at the city gate. He read from the Illinois Bell Telephone case, which required that there be findings upon this issue, and then said: "That is, as I understand it, the Supreme Court remanded this case for findings as to what it cost the Western Electric Company to produce the material which it sold to the Bell Company. I wondered if you had given that consideration." Then he quoted further from that opinion and asked: "You have not prepared any statement along that line?" (R. 68)

Commissioner Montgomery also asked for additional evidence as to the 1¾ per cent charge and as to the

managerial charge, and when the witness testified that they did not have any such information prepared, he asked if the books of the company would be available for the Commission, so that the Commission could ascertain such evidence for itself. The books being outside the state they could not be subpoenaed by the Commission. The attorney for the applicant then stated:

> "They are not and the courts have held it was not necessary for the Commission to have them." (R. 71)

Again with Mr. Adams on the stand he was asked:

> "Q. As an officer of the Western Distributing Company you do know what—or have information as to what services you pay for, or whether or not these services are reasonable, do you? A. Yes, sir.
>
> "Q. Will you produce that information? A. I will be guided by advice of attorneys." (R. 71)

This clearly indicates that paragraph XIII of the amended bill is without support in the record before the Commission.

3. Appellant's allegation that it offered in evidence decisions of the Supreme Court of Kansas and of the Federal Courts.

It is true that these decisions were offered in evidence, but the record of the decisions was not offered. The decisions are not *res adjudicata* and the law pronounced in a number of them is not altogether in conformity with the recent decision of the United States Supreme Court. The withdrawal of the record of the Wichita gas case

from the hearing before the Public Service Commission withdrew the part of the proceedings in the cases referred to which the appellant now contends would have enabled the Commission to make the necessary findings.

4. Appellant's allegation that the holding company charges could have been disallowed by the Commission without affecting the findings.

The plaintiff seems to overlook the proposition that the Commission must establish a definite rate. It could not make specific findings as to part of expenses and guess at the remainder and base the rate upon such a guess. If, however, the plaintiff is willing to forfeit its holding company charges there can be no argument about the sufficiency of the present rate. Payment to Henry L. Doherty & Company amounted to $3,454.43, and payment to the Gas Service Company amounted to $10,638.02; excess leakage, which the plaintiff admitted should be deducted in part, amounted to $23,000; merchandising expense and new business expense, which the courts have held is not a proper item to be considered in a rate case, amounted to $12,560. All of this item should not be deducted, but the evidence did not show the proper amount. This made a total expense of $46,198.02, not taking into consideration the $176,260.32 paid the holding or affiliated company for gas purchased.

5. Appellant alleged in paragraph XIII that it was surprised by the motion to dismiss, there being no request for findings as to the managerial charges and that plaintiff was led to believe that no such request would be made.

We have discussed under the second allegation set out above the repeated requests of the members of the Commission and their attorneys for additional information as to these managerial charges. It would serve no useful purpose to repeat that evidence here. It suffices to say that the Commission did ask for such information and it was refused on the advice of counsel; that the Commission had quoted from the Illinois Bell Telephone decision showing to the appellant that such evidence was necessary and that such findings must be made, in an effort to get the appellant to produce such testimony.

6. Appellant's allegation that the transcription of its testimony in each rate case would be an impossibility because a number of the small towns would not justify the expenses.

That contention is without merit. Henry L. Doherty & Company and the affiliated gas companies involved in this litigation have available books containing the desired information. The Commission did ask the Distributing Company to produce such information and when it refused asked for access to its books so that it could obtain the information for it. This was also refused. This information once obtained and properly made in exhibit form could be used in each of the cities under the control of the Distributing Company, and so far as time and

financial output is concerned their introduction in the separate cases would not consume fifteen minutes.

It might as well be admitted here that a certain amount of controversy has existed between these affiliated gas companies and the Public Service Commission for a number of years. The gas companies have been before the Commission for an increase in rates, they have cited the decisions of the courts and have refused to produce the desired information. Then they have gone into the courts and stood on the ground that the Commission was without authority to go into the books and into the pipe-line valuation. This has left a condition which is neither satisfactory to the Commission nor to the public generally and has placed the pipe line company in a position of suspicion. If their charges are reasonable and their records are clear there should be no objection to a disclosure. If they are otherwise public policy demands that a full disclosure be made. The Commission will be satisfied once a complete investigation of the pipe-line company is made and the books of the company have been audited, and it will be willing to take the gate rate found after such investigation and use it as a starting point for future rate cases. The Commission cannot be satisfied with anything short of such a complete disclosure.

The legislature of the State of Kansas has set up a Public Service Commission and given it the proper machinery with which to regulate public utilities and investigate rates. It is before this administrative body, as established by the legislature of the State of Kansas, that

the utilities should be required to seek their relief before going into the courts.

When a utility appears before the Public Service Commission the Commission and the utility should not be in the position of two litigants. The utility should not be allowed to make a brief showing and place the burden upon the Public Service Commission to find what the rate should be. In a majority of cases the evidence is strictly within the knowledge of the utility and can be disclosed only by the records of the company.

We believe that the foregoing statement as supported by the record clearly establishes the fact that the appellant labored under the impression that it was not necessary to make a showing as to the cost of rendering services by a holding company, and is now laboring to cover up that error.

THE ISSUE OF LAW.

It is the contention of the appellees, under the facts heretofore set out, that the amended bill of complaint was properly dismissed under the issues raised by the appellees' answer. The bill was premature in that the appellant had not exhausted its relief before the Commission. The relief is legislative and must be exhausted before a public utility can ask relief from the courts. Relief before the Commission has not been exhausted where the utility has failed to produce evidence upon which the Commission can make a finding upon all material issues.

fore rates are fixed." (*Vincennes Water Supply Co. v. Public Service Commission*, 34 F. [2d] 5.) (Cer. denied. 280 U. S. 562, 72 L. Ed. 427.)

"Questions whether tariffs imposed by carriers are discriminatory must be raised in first instance before Interstate Commerce Commission or state public utilities commission." (*Oregon Short Line R. Co. v. Teton Coal Co.*, 35 F. [2d] 919, Syl. 9.)

"A temporary injunction will not be issued to prevent a state commission from compelling an interstate railroad to submit to its jurisdiction with respect to the location of its division point within the state, where there is nothing to show that the railroad company would be prejudiced by participating in the hearing before the commission, and awaiting the result thereof." (*Lawrence v. St. Louis-San Francisco Railway Co.*, 274 U. S. 588, 71 L. Ed. 1219.)

"Commission was fully justified in refusing to sanction a discontinuance of service until a petition had been filed with the commission and a showing made." (*Western and Atlantic R. v. Georgia Public Service Commission*, 267 U. S. 492, 69 L. Ed. 753.)

"The question of constitutionality of a state statute prohibiting a railroad from abandoning any portion of its service to the public without first obtaining permission from the state public service commission may not be raised by a railroad company which has discontinued interstate trains rendering intrastate service without first applying to the state public service commission for permission to do so, where no emergency existed requiring immediate action." (*St. Louis-San Francisco Ry. Co. v. Alabama Public Service Commission*, 279 U. S. 843, 73 L. Ed. 560.)

The same rule has been applied in attempts to resort to courts before presenting the issues to the Interstate Commerce Commission.

In *Simpson v. Shepard*, 230 U. S. 352, 419, 57 L. ed. 1511, 1550, the Supreme Court, speaking through Chief Justice Hughes, said:

> "The dominating purpose of the statute was to secure conformity to the prescribed standards through examination and appreciation of the complex facts of transportation by the body created for that purpose, and as this court has repeatedly held, it would be destructive of the system of regulation defined by the statute if the court without preliminary action of the commission were to undertake to pass upon the administrative questions which the statute has primarily confided to it."

In *Great Northern R. Co. v. Merchants Elevator Company*, 259 U. S. 285, 291, 66 L. Ed. 943, 946 it was said:

> "Whenever a rate, rule or practice is attacked, as unreasonable or as unjustly discriminatory there must be preliminary resort to the Commission. Sometimes this is required because the function being exercised is in its nature administrative, in contradistinction to judicial. But, ordinarily, the determining factor is not the character of the function, but the character of the controverted question and the nature of the inquiry necessary for its solution. To determine what rate, rule, or practice shall be deemed reasonable for the future is a legislative or administrative function. To determine whether a shipper has in the past been wronged by the exaction of an unreasonable or discriminatory rate is a judicial function. Preliminary resort to the Commission is required alike in the two classes of cases. It is required because the inquiry is essentially one of fact and of discretion in technical matters, and uniformity can be secured only if its determination is left to the Commission."

The appellant lays considerable stress upon the fact that an injunction proceeding against the Public Service Company is a trial *de novo*. On page 41 of its brief, the appellant states:

> "We supposed the law to have been well settled at the time this proceeding was heard by the court below that injunction proceedings brought to test orders of the Commission were trials *de novo* in which the proceedings before the Commission were entirely immaterial except as they might reflect upon the good faith of the party asking courts for relief."

On page 8 of its brief, the appellant also states:

> "Little is said in the Kansas statute in regard to the nature of the proceedings before the Commission and the same has been established more by custom and the decisions of the courts than by statutory provision. The proceedings are most informal and the Commission is authorized to procure its information in any reasonable manner, it being left to the courts to correct any injustice which might result to either party."

The appellant does and has appeared to labor under the impression that their showing before the Commission was entirely immaterial, and they were interested only in getting past the technical fact finding body of the Commission and into the courts. This, we do not believe to be the intention of the Public Service Commission statute, nor do we believe it to be the law as pronounced by the courts. Preliminary resort to the Commission is required because as stated, in Great Northern R. R. Co. v. The Merchant's Elevator Co., supra: "The inquiry is essentially one of fact and one of discretion

in technical matters, and uniformity can be secured only if its determination is left to the Commission." The legislative regulation of utility rates would be absolutely destroyed if utilities were permitted to submit but a small part of their evidence to the Commission—that is, to make what they call a "good faith showing"—and then go into the courts, submit all their evidence and ask for injunctive relief. This same situation was before the Supreme Court of the United States in Cincinnati, N. O. & T. R. R. Co. vs. The Interstate Commerce Commission, 162 U. S. 184; 40 L. Ed. 935, and the court held:

> "It is not proper for railroad companies to withhold a large part of their evidence from the Interstate Commerce Commission and first adduce it in the Circuit Court in proceedings by the Commission to enforce its order; but the purposes of the act of congress to regulate commerce called for a full inquiry by the Commission in the first instance." (Syl. 4.)

We also submit that the purpose of the public utility laws to regulate public utilities calls for a full inquiry by the Commission in the first instance. The utility having made a full disclosure before the Commission is then justified in seeking a trial *de novo* by injunction in the courts if it feels that it has a [redacted] grievance.

The dismissal of the bill of complaint now complained of by the appellants is simply a correction of their mistaken idea set out above—that the proceedings before the Commission were entirely immaterial as to the sufficiency of showing made by the utility to the Commission.

2.

A utility has not exhausted its remedy before the Commission until it has produced evidence upon which findings can be made upon all material issues affecting the rates.

Having determined that a utility must exhaust its remedy before the Commission before seeking injunctive relief, it now remains to be determined whether relief before the Commission is exhausted where the applicant seeking an increase in rates fails and refuses to introduce evidence upon such material issue upon which the Commission can make a finding.

To hold that a utility could make application for an increased rate and refuse to produce evidence justifying such increase would destroy any attempt to regulate rates by a commission. This would especially be true where the evidence is in possession of the applicant and they refused to produce it.

Should a utility be permitted to come before a commission, ask for an increase and state that they are operating at a loss, and rest their case? Such conduct could never be permitted before a fact-finding tribunal. The danger of such practice was very well expressed in the case of *Chicago & G. T. Ry. Co. v. Wellman*, 143 U. S. 338, 36 L. Ed. 176.

In determining the validity of a rate order, where confiscation was alleged under the federal constitution, the court said:

> "It is agreed that the defendant's operating expenses from 1888 were $2,404,516.54. Of what do these operating expenses consist? Are they made up

partially of extravagant salaries; fifty to one hundred thousand dollars to the president, and in like proportions to subordinate officers? Surely, before the courts are called upon to adjudge an act of the legislature fixing the maximum passenger rates for railroad companies to be unconstitutional, on the ground that its enforcement would prevent the stockholders from receiving any dividends on their investments, or the bondholders any interest on their loans, they should be fully advised as to what is done with the receipts and earnings of the company; for if so advised, it might clearly appear that a prudent and honest management would, within the rates prescribed, secure to the bondholders their interest, and to the stockholders reasonable dividends. While the protection of vested rights of property is a supreme duty of the courts, it has not come to this, that the legislative power rests subservient to the discretion of any railroad corporation which may, by exhorbitant and unreasonable salaries, or in some other improper way, transfer its earnings into what it is pleased to call 'operating expenses.'

"We do not mean to insinuate aught against the actual management of the affairs of this company. The silence of the record gives us no information, and we have no knowledge outside thereof, and no suspicion of wrong. Our suggestion is only to indicate how easily courts may be misled into doing grievous wrong to the public, and how careful they should be not to declare legislative acts unconstitutional upon agreed and general statements, and without the fullest disclosure of all material facts."

The Commission had denied the application, out of which this application for a restraining order grew, for failure to make a full disclosure of all material facts.

"The burden of proof that the proposed increase, charge or alteration in rates is just and reasonable

is placed upon the utility making the application." (*New Jersey C. T. Co. v. Board of P. U. B. Utility Commissioners*, N. J. L., 113 A. T. L. 692.)

The Supreme Court of New Jersey dismissed the writ upon the ground that the commission properly denied the application because of insufficiency of the utility's showing.

On page 8 of its brief, appellant states:

> "Little is said in the Kansas statute in regard to the nature of the proceedings before the Commission and the same had been established more by custom and the decision of the courts than by statutory procedure."

The following excerpts from public utility cases will show that the custom and general practice of the Commissions in all states has been to deny the application where the record is insufficient to justify a finding on all material issues.

In *In re Long Island R. R. Co.*, P. U. R. 1928-C, 705, it was said:

> "The burden of proving the proposed rates to be just and reasonable rests squarely upon the utility. *** The commission, as a fact finding body, cannot make an order based on conjecture and should be furnished with sufficient facts to show definitely the reasonableness of proposed rates."

In the opinion it was said:

> "The burden of proof to justify the reasonableness of the proposed tariffs was upon the railroad company. The manner, form and extent of its proof was of its own choosing. The failure to supply ad-

ditional or more persuasive cost figures was brought to its attention during the progress of the proceedings. *** It follows that an order should be made dismissing the filed schedules because of the failure of the company to furnish satisfactory or convincing proof that the proposed increased rates are just and reasonable." (Page 747.)

The general practice of commissions in all states has been to deny the application where the record is insufficient to justify an order.

"The application for increased rates should be denied when the record is such that from it no finding can be made that the proposed rates are just and reasonable." (*Bell Telephone Company*, P. U. R. 1925-E, 242.)

"An order with reference to a continuance of a public utility company's present rates will be denied when there is no evidence before the Commission to justify such an order." (*City Light & Transit Co. of Sedalia*, P. U. R. 1922-E, 474.)

"A natural gas distributing company applying for increased rates failed to carry the burden of proof placed upon it by statute when it failed to inform the commission as to the actual cost of gas purchased from the affiliated company." (*Point Pleasant Natl. Gas Co.*, P. U. R. 1927-B, page 805.)

In the above case the application was dismissed without prejudice.

It could not be very seriously contended that a public utility had exhausted its remedy before a fact-finding tribunal where there was not sufficient evidence before the fact-finding body to justify a finding.

Cases can be found from practically every commission in the Union, holding that the burden is upon the utility to prove every issue material in the determination of a rate case.

Listed below are some of the decisions rendered since 1921:

"Upon the hearing of an application of a public utility company to increase its rates or charges, the burden of showing that the proposed increase is just and reasonable is cast upon the utility." (*National Gas Co. v. Public Service Commission,* [W. Va.] 121 S. E. 716.)

"An application for increased rates must be denied when the applicant fails to sustain the burden of proof as to the necessity for such increase by showing the present fair value of the property in addition to evidence as to the expense of operation and revenue received."

"The prayer of the applicants for increased rates must be denied because of their failure to sustain the burden of proof as to the necessity for such increase." (*Re Metz Tel. Co.,* P. U. R. 1927-E, 624.)

"The burden justifying the reasonableness of rates against which a complaint has been filed before the effective date rests upon the utility." (*Burrough of Warren v. Warren Water Co.,* P. U. R. 1924-B, 400.).

"Application for increased rates must show not only that the increase is justified because the existing rates are too low, but also that the proposed rates are themselves reasonable." (*Re Puente City Water Company,* P. U. R. 1921-C, 451.)

"The burden of proof as to the necessity for increased rates rests upon the utility." (*Thompson's Express & S. Co.,* P. U. R. 1921-A, 211.)

"A gas utility must prove the reasonableness of a new rate schedule in a proceeding instituted by complaint against certain schedules." (*Department of Public Works v. Tacoma L. & Imp. Co.*, P. U. R. 1925-A, 165.)

"A preponderance of evidence is required in order to establish legally the proposed rate increase as just and reasonable where by statute the utility has the burden of proof that such is the case." (*Re Logan Gas Company*, P. U. R. 1929-A, 232.)

"The burden of proof sustaining the reasonableness of increased rates was held to be upon the utility." (*Burrough of M. Cabon v. Pottsville Water Co.*, P. U. R. 1928-B, page 614.)

"Upon appearing before the commission for authority to increase rates the officers of a public utility should state definitely their conclusions as to the company's needs, or as to the rate schedule which they regard as necessary for the future, since this is the company's responsibility and a commission should not have delegated to it duties which are obtrusively and manifestly the company's." (*Re Comstock Ind. Telephone Co.*, P. U. R. 1922-B.)

"A telephone company applying for increased rates assumes the burden of proof to justify the increase; and it becomes incumbent upon the company to establish, to the satisfaction of the commission, the value of the property of the company in the state which is used and usable for the service of the public." (*Re Cumberland Tel. and Tel. Co.*, P. U. R. 1921-D, 858.)

The principle that the party upon whom rests the burden of proof must establish its case before it can obtain relief is too well determined to justify discussion.

There are three principles to be established to support the decree dismissing the bill of complaint.

1. The utility must exhaust its remedy before the Commission before seeking injunctive relief.

2. A utility has not exhausted its remedy before the Commission until it has produced evidence upon which findings can be made upon all material issues affecting the rate.

3. The cost of services rendered and gas furnished by a holding or affiliated company is a material issue in a rate case in determining the reasonableness of holding and affiliated company charges.

If these contentions are sustained, the bill of complaint was properly dismissed. They will be discussed in the order in which they appear.

I.

The utility must exhaust its remedy before the Commission before seeking injunctive relief.

As to whether or not a public utility must exhaust its remedy before the Commission before applying for judicial or injunctive relief there can be very little dispute. The legislature may within the limit of constitutional restrictions place regulation upon public utilities. Regulation of public utilities by the Public Service Commission is purely legislative or administrative. The courts will not interfere with legislative regulation until it has been abused, and the abuse will not be anticipated.

The legislative power to regulate utility rates would be absolutely destroyed if utilities were permitted to first

seek the courts to compel the legislative body to submit to the will of the utility.

Statements from a few of the cases determining this question follow. None can be found to the contrary.

In *Chicago, Burlington & Quincy R. Co. v. Winnett*, 162 Fed. 242, the court held:

"A court of equity is without power to interfere by injunction to control in advance the exercise of the legislative power conferred on the state railway commission by the constitution and statutes of Nebraska to fix reasonable and just rates for the transportation of property between points within the state, by restraining such commission from considering or acting upon the question of establishing new rates on any given commodities, or from giving notice to a railroad company of any order which may be adopted establishing such rates." (Syl.)

"Before complainant can secure judicial relief on account of past divisions of intrastate joint rates, it must first apply to state railroad and warehouse commission, and have the preliminary question of what is a fair division of the rates involved first determined by that commission." (*Backus-Brooks Co. v. Northern Pacific Ry. Co.*, 21 F. [2d] 4, Syl. 17.)

"Injunction will not lie on behalf of water company which is bound by franchise to supply water at specified rates to enjoin the public service commission to continue in force rates permitted by it in excess of the franchise rates as being confiscatory where *** the water company has not exhausted its remedy before the commission, by applying for relief as it was authorized by the Commission to do." (*Henderson Water Co. v. Corporation Commission*, 269 U. S. 277, 70 L. Ed. 273.)

"Railroad companies may not be granted an injunction against the State Railroad Commission be-

The Supreme Court of the United States has held that the Public Service Commission of the state of Kansas cannot change rates without a finding as to reasonableness.

In *Wichita Railroad & L. Co. v. Public Utilities Commission*, 260 U. S. 47, 67 L. Ed. 124, the court in an opinion rendered by Chief Justice Taft held:

> "In the absence of any finding by the public service commission upon the question of reasonableness or unreasonableness of a rate which it is asked to change, its ruling authorizing the change cannot be supported by the presumption that there was evidence which would warrant a finding of unreasonableness, notwithstanding the statute provides that rates fixed by the Commission shall be *prima facie* reasonable. (For other cases see Evidence, 11, *a*, in Digest Sup. Ct. 1908.)" (Syl. 8.)

> "Under a statute permitting a public service commission to change contract rates of a public corporation if, after hearing, they are found to be unjust, an order changing a contract rate without such finding is void." (Syl. 9.)

The Western Distributing Company failed and refused to submit evidence upon material issues before the Commission upon which it could make findings. It must do so before it is in a position to seek injunctive relief.

In *Smith v. Illinois Bell Telephone Co.*, supra, the court said:

> "Specific findings with regard to the cost to the American Telegraph and Telephone Company of services rendered by it to a subsidiary company, in respect of which a charge is made to the subsidiary company, and the reasonable amount which should

> be allocated in this respect to the operating expenses of the intrastate business of the subsidiary company are necessary to a determination of the question whether rates prescribed by a state public utilities commission afford an adequate return."

In line with this decision it is imperative upon the Public Service Commission to make findings upon the cost to the holding and affiliated companies in respect to service charges figuring in the items of expense of the subsidiary company. Certainly the utility must produce sufficient evidence to enable the Commission to make all required findings.

The evidence which the Western Distributing Company refused to submit to the Public Service Commission must be submitted to the Federal Court to justify relief there. This same situation was before the Supreme Court of the United States in *Cincinnati, N. O. & T. P. R. Co. v. Interstate Commerce Commission*, 162 U. S. 184, 40 L. Ed. 935, and the court held:

> "It is not proper for railroad companies to withhold the larger part of their evidence from the Interstate Commerce Commission, and first adduce it in the circuit court in proceedings by the Commission to enforce its order; but the purposes of the act of congress to regulate commerce call for a full inquiry by the Commission in the first instance. (Syl. 4.)"

In a rate hearing before the Public Service Commission a definite rate must be established. The Commission cannot, when insufficient evidence is submitted, guess at what increase should be allowed. Although the record

might indicate the necessity for an increase, the Commission must have definite evidence upon which to base a definite rate.

The Western Distributing Company, in its application for an increase in rates, requested the installation of the "three-part rate". The "three-part rate" bases the payment to the pipe-line company on a percentage of the earnings of the distributing company and not on a fixed price at the city gate. Therefore the "three-part rate" can be constructed only after taking into consideration (*a*) the cost of operating and maintaining the producing and transmission system of the Cities Service Gas Company, and (*b*) the fair value of the producing and transmission system of that company. The record contains no evidence which would enable the Commission to give these matters consideration.

3.

The cost of service rendered and gas furnished by a holding or affiliated company is a material issue to be determined in a rate case as a test of the reasonableness of the contracts.

The necessity of the Commission taking into consideration cost of service rendered or gas supplied by an affiliated and holding company has been very definitely determined. If an affiliated or holding company is being unjustly enriched by charges made to a subsidiary company the excess charges must be deducted from the expense items. The subsidiary company is dominated and controlled by the holding company. To allow it to exact

from the subsidiary company an excessive charge for services rendered without taking such excessive charges into account in determining a proper rate would destroy any attempt at regulation.

The legislative power to regulate rates cannot be made subservient to the discretion of a holding company which may by exhorbitant and unreasonable charges, or in some other improper way, transfer the earnings of a subsidiary distributing company into what it is pleased to call "expense items" for its own enrichment. It matters little to the holding company whether the earnings appear as dividends from the subsidiary company or excess earnings on the part of the parent company. The money all goes into the same pocket.

It is true the Cities Service Gas Pipe Line Company which delivers gas to the Western Distributing Company is an Interstate pipe line. It is also true, however, that all the capital stock of the Cities Service Gas Company (the pipe line company), through intercorporate relations, is owned by the Cities Service Company, a holding Company. All of the capital stock of the Western Distributing Company, through intercorporate relation, is owned and controlled by the Cities Service Company, the same holding company, the earnings of both companies go directly to the treasury of the Cities Service Company.

The authority of the Public Service Commission to consider the reasonableness of contracts made between holding or affiliated companies is not a novel question. That principle was pronounced by the Courts in several

cases prior to the decision in Smith v. Illinois Bell Telephone Company, 282 U. S. 133.

In the case of the United Field Gas Company v. Railroad Commission, 278 U. S. 300, the court said:

> "We need not labor the point that a Public Service Corporation may not make a rate confiscatory through the device of a contract unduly favoring a subsidiary or a corporation owned by its own stockholders."

It was also held:

> "In computing the income of a natural gas company to determine whether or not a rate is confiscatory, it may be credited with 50 per cent of the net earnings of a subsidiary corporation which is accorded the privilege of extracting gasoline from the gas, if it bears the expense of property used for extraction in excess of the proportional return received by it for the extraction, and the profits of the subsidiary are excessive, although by contract it is entitled to only one-eighth of the gross profits from the extraction." (Syl. 16.)

This is true regardless of the fact that the supply company is transporting gas in interstate commerce. In the case above referred to, the United Field Gas Company was engaged in the business of producing natural gas from gas fields located principally in West Virginia which it sold to consumers in West Virginia, Kentucky and Ohio. This rule was also recognized in the cases of Houston v. Southwestern Bell Telephone Company, 259 U. S. 318 and Southwestern Bell Telephone Company v. The Public Service Commission, 262 U. S. 276.

In opposition to this theory, the appellant on page 32 of its brief quotes in the first paragraph of the syllabus, in the case of Missouri v. Kansas Natural Gas Company, 265 U. S. 298, as follows: "The business of piping natural gas from one state to another and selling it, not to consumers, but to independent distributing companies which sell it locally to the consumers, is interstate commerce free from interference."

It will be noticed in this statement that the court carefully mentioned the fact that the pipe line company was selling gas to independent distributing companies. The pipe line company in that case was not selling to affiliated or subsidiary companies.

At the present time, there is no Federal legislation regulating pipe line companies selling gas in interstate commerce. If the states are without authority to investigate the reasonableness of contracts made between interstate pipe line companies and subsidiary or affiliated distributing companies, there is no way in which the states can regulate the rate at which gas is to be sold to the local consumer.

Because of the expenditure involved in the construction of a gas pipe line system, it is not practicable for two pipe line companies to invade the same territory. Where a pipe line company is supplying a territory such as that now under consideration it has virtually a monopoly so far as sales to distributing companies are concerned. It is not possible for the distributing plants to buy gas from some other source, or at a cheaper rate, because another pipe line company cannot economically

invade the territory. Where both the pipe line and the distributing plants are owned and controlled by a common holding company, a situation is created which makes it possible for the pipe line company, through its holding company, to exact most any price it desires from the affiliated distributing company for gas purchased. This cost is passed on to the local consumer in the form of excessive rates made possible by heavy expense items for gas purchased.

It is an old established rule of law that the states may make regulations indirectly affecting interstate commerce when needed to protect or regulate matters of local interest until congress regulates the subject matter for itself.

This rule was applied in the case of Pennsylvania Gas Co. v. Public Service Commission, 252 U. S. 23, to an interstate gas pipe line. Although this case was disapproved in East Ohio Gas Co. v. Tax Commission, 75 L. ed. 700, it was only to the extent that the sale of gas at the burner tips was intrastate and not interstate commerce and the rule as above stated was in no way disapproved or effected. In the Pennsylvania Gas Co. case, the court said:

> "The general principle is well established and often asserted in the decisions of this court that the state may not directly regulate or burden interstate commerce. That subject, so far as legislative regulation is concerned, has been committed by the Constitution to the control of the Federal Congress. But while admitting this general principle, it, like others of a general nature, is subject to qualifications not inconsistent with the general rule which now are as well established as the principle itself.

> In dealing with interstate commerce it is not, in some instances, regarded as an infringement upon the authority delegated to Congress, to permit the states to pass laws indirectly affecting such commerce, when needed to protect or regulate matters of local interest. Such laws are operative until Congress acts under its superior authority by regulating the subject-matter for itself."

Again, in the opinion, the Court stated further:

> "It may be conceded that the local rates may effect the interstate business of the company. But this fact does not prevent the state from making local regulations of a reasonable character. Such regulations are always subject to the exercise of authority by Congress, enabling it to exert its superior power under the commerce clause of the Constitution."

We respectfully submit that if the interstate commerce feature of the gas pipe line business is indirectly affected by the commission's investigation of the reasonableness of the contract by the affiliated distributing company, it is only to the extent needed to protect and regulate matters of local interest to the state pertaining to the rates to be charged to the local consumers by the distributing company.

We are also reminded of the fact that because of the close relationship between the pipe line company and the distributing company, both being owned and controlled by a common holding company, that for all practical purposes, both the pipe line and the distributing plant are under the control and supervision of one company, and do not operate independently of each other so far as management is concerned.

In the present case, it will be noted that the lower court carefully restricted the investigation which the commission could make into the pipe line rate to a test as to whether or not the contract between the pipe line company and the distributing company was reasonable. In the opinion of the lower court (R. 52) it was stated:

> "It cannot be questioned that the forty-cent rate at the city gate is an interstate rate which the commission cannot directly regulate. It does not follow, however, that the commission may not inquire into the reasonableness of that rate for the purpose of fixing the local rates which plaintiff may charge in the city of El Dorado. Smith v. Illinois Bell Tel. Co., 282 U. S. 133; Houston v. Southwestern Bell Tel. Co., 259 U. S. 318; Southwestern Bell Tel. Co. v. Pub. Serv. Comm., 262 U. S. 276. It is my opinion that the commission, in making inquiry into the city gate rate, should not approach that question as it would were it empowered to fix such rate. The inquiry should be for the purpose of determining whether the contract between plaintiff and the Cities Service Gas Company, an affiliated corporation, is fair and reasonable, and such as prudent business men acting in good faith and in the exercise of a sound discretion would have entered into under similar circumstances. To put it another way: The commission may not fix an interstate rate, but it may determine whether a corporation buying gas from a related and affiliated corporation is paying such affiliated corporation an unfair and fictitious charge, under the existing circumstances, for gas at the city gate, and using that charge as one of the elements of cost upon which it seeks to have the local rate fixed. The commission may make inquiry into value of property, costs, profits, limitation on source of supply, and other pertinent factors in determining whether, under the existing circumstances, the con-

> tract is fair and reasonable and was made in good faith; but it may not go to the extent of fixing and determining the rate at the city gate."

The lower court carefully restricted its decision and opinion to conform to the previous rule announced in the cases therein cited. It is our belief that the opinion therein announced sustained the decree of dismissal. We do not believe, however, that the opinion goes far enough. So far as the facts are concerned in this case, the Intercompany relations are identically the same as that in the case of Smith v. Illinois Bell Telephone Company, 282 U. S. 133, and in that case, the rule was properly extended to make the cost of service rendered by a holding or affiliated company and the rate of return earned by it the full measure of the test of the reasonableness of the contract.

In the Smith case, the court in speaking of the necessity of findings as to the profits made by an affiliated manufacturing company on the sale of equipment to the telephone company and as to the extent to which such profits figures in estimates upon which is predicated the claim that the telephone rates fixed by the Public Utilities Commission were confiscatory, said:

> "Contentions of the appellants in this relation are directed to the purchases from the Western Electric Company and to the payments to the American Company under what is called its 'license contract'. It appears that the Illinois Company has purchased practically all its equipment from the Western Electric Company. The state commission in laying the basis for its rate order made no finding as to the

fairness of the prices on such purchases. On the record in this suit, the court concluded that the city had failed to support its contention that these prices were exhorbitant. The court said that it appeared that for the past fourteen years the average profit of the Western Electric Company on its total business had not been 'in excess of 7 per cent and never above 10 per cent'. That fact has evidentiary value but the finding does not go far enough. The Western Electric Company not only manufactured apparatus for the licensees of the Bell System, but engaged in other large operations, and it cannot be merely assumed or conjectured that the net earnings on the entire business represent the net earnings from the sales to the Bell licensees generally or from those to the Illinois Company. Nor is the argument of the appellants answered by a mere comparison of the prices charged by the Western Electric Company to the Illinois Company with the higher prices charged by other manufacturers for comparable material, or by the Western Electric Company to independent telephone companies. The point of the appellants' contention is that the Western Electric Company, through the organization and control of the American Company, occupied a special position with particular advantages in relation to the manufacture and sale of equipment to the licensees of the Bell system, including the Illinois Company, that is, that it was virtually the manufacturing department for that system, and the question is as to the net earnings of the Western Electric Company realized in that department, and the extent to which, if at all, such profit figures in the estimates upon which the charge of confiscation is predicated. We think that there should be findings upon this point (p. 152)."

Again, in the opinion, the Court said:

> "In view of the findings, both of the state commissions and of the court, we see no reason to doubt that valuable services were rendered by the American Company, but there should be specific findings by the statutory court with regard to the cost of these services to the American Company and the reasonable amount which should be allocated in this respect to the operating expenses of the intrastate business of the Illinois Company in the years covered by the decree (P. 157)."

Under the authority of this decision, it is our contention that there should be specific findings in regard to the cost of the services of the holding and affiliated companies in order to determine the reasonable amount which should be allocated in this respect to the operating expenses of the Western Distributing Company.

On page 26 of its brief, appellant states:

> "A reading of the motion upon which the proceedings before the Commission were dismissed shows very clearly that at that time the commission construed the Smith case as requiring a showing in every rate case as to the cost of gas to supply the company at the gate of each City where the distributing company and supply company are affiliated."

It is further contended that the cost of supplying gas to each distributing company is the same all over the system and the cost cannot be separated. This contention was not made before the Commission. At the hearing before the court below, affidavits were introduced by the appellant to that effect. We cannot see where the obligation of the appellant is changed by that showing.

If the situation is as claimed by the appellant, it was its duty to make such proof before the Commission and then proceed to justify the reasonableness of the system rate. The reasonableness of that contracted rate once established, would, if the appellant's theory in opposition to zoning were correct, eliminate the necessity of such showing in but one rate case. When the hearing was had before the lower court, the appellees made a stipulation as shown on page 47 of the record, as follows:

> "At the hearing, it was stipulated and agreed by the Commission through its counsel for the purposes of this hearing only, that the territory served by the pipe line company could not be segregated into separate zones for the purpose of fixing different cost of gas at the city gates in different zones."

This would simplify the controversy by enabling the company to make one showing as to the reasonableness of the pipe line rate over the entire system and the obligation upon the appellant to show the reasonableness of the contract for gas at the city gate exists whether it be for each individual distribution company or for the city as a whole.

To the two other items in controversy, the same reason would apply as that advanced in the previous argument.

> "The Gas Service Company operates and manages the Western Distributing Company and keeps the books of the Western Distributing Company in Kansas City, Missouri, and charges to the Western Distributing Company certain sums annually purporting to be the Western Distributing Company's share of expense of the Gas Service Company. These charges,

amounting to $5,970.11, were included in the items of expense for the El Dorado plant, also unclassified expense amounting to $4,667.91, which was reimbursement for specific services rendered. (R. 63)"

In view of the fact that the Gas Service Company owns all of the capital stock of the Western Distributing Company, there should be a showing made to the Commission as to what it cost the Gas Service Company to operate and manage the Western Distributing Company.

"Henry L. Doherty, doing business as Henry L. Doherty & Company, through agency contracts, manages and controls the operations of all these companies, both in their relations with the public and between themselves.

"The Western Distributing Company pays 1 3/4 per cent of its gross revenue to Henry L. Doherty & Company. This payment in the amount of $3,454.43 was included in the items of expense for the El Dorado plant." (R. 63)

In view of the fact that Henry L. Dougherty and Company for all practical purposes has control of the voting stock of the Cities Service Company, which, through intercorporate relation owns and controls the stock of the Western Distributing Company, there should be a showing made as to what it costs Henry L. Doherty and Company for services performed, if any, and to show whether or not Henry L. Doherty and Company renders any services to Western Distributing Company, or whether its efforts are expended in the management of the Cities Service Company in the sale of its securities and that service paid for by the local operating units.

ASSIGNMENT OF ERROR No. IV.

On page 25 of its brief, appellant objects to the failure of the lower court to make its requested finding set out as 7A on page 45 of the record. It does appear that an inadvertent admission was erroneously made in paragraph 13 of appellees' answer, as follows:

> "It is admitted that the defendant, the Public Service Commission, should and did take notice of the decisions referred to and the respective records, but it is averred that the defendant, The City of El Dorado, had and has no knowledge thereof." (R. 38)

There can be no question but what the Commission must take notice of the decision of both the State and Federal Courts. The record in these cases, however, was not before the Commission. After the hearing was dismissed by the Commission, counsel for appellant moved to reopen the case and introduce the record of the Wichita Gas case, but after attorneys for the Commission asked for time to examine the record, counsel for appellant stated: "I will withdraw the motion. I would rather get it started in the courts and find out what the law is now." (R. 80) There was, therefore, nothing before the Commission upon which it could make a finding, and the counsel intentionally withdrew such record from the Commission for the purpose of having determined the question of whether or not the reasonableness of the contracts between the distributing company and the holding or an affiliated company was a matter into which the Commission could inquire.

This fact being in the undisputed evidence presented to the lower court, we contend that the requested finding was probably rejected, especially in view of the fact that in the hearing before the Commission the limited investigation of reasonableness of the contracts in the Wichita gas case was disclosed.

> "In response to an inquiry by Mr. Montgomery, then a member of the Commission, it was stated: That the only valuation introduced was a general estimate by Mr. Hamilton, chief engineer of Henry L. Doherty & Company, which was a general estimate in round figures. No exhibit was introduced, but his testimony occupied a day or two. It was stated by counsel for the applicant that no valuation, to his knowledge, had been made of the pipe line system; that he had been informed that it would cost $50,000.00 to $100,000.00 to make it." (R. 68)

CONCLUSION.

We respectfully submit that whether or not the present rate for the Western Distributing Company's operating unit at El Dorado, Kansas, is confiscatory, cannot be determined until there is a showing made as to what it costs the affiliated and holding companies to render the services and furnish gas and a showing made as to the profit of such company and the extent to which such profit figures in estimates on which is predicated the claim that the present rate at El Dorado, Kansas, is confiscatory; that the appellant is required to make such showing before the Commission, and that the appellant failed and refused to make such showing or to give the

Commission access to its books, so that it could acquire the information for itself.

We further submit that the appellant has not exhausted its administrative remedy before the Commission, and that the court below ruled correctly in denying appellant's application for a preliminary injunction and in dismissing the bill of complaint.

CHARLES W. STEIGER,
Topeka, Kansas,
EARL H. HATCHER,
Topeka, Kansas,
Solicitors for Appellees.

SUPREME COURT OF THE UNITED STATES.

No. 337.—October Term, 1931.

Western Distributing Company, Appellant, *vs.* The Public Service Commission of the State of Kansas, et al.	Appeal from the District Court of the United States for the District of Kansas.

[February 29, 1932.]

Mr. Justice Roberts delivered the opinion of the Court.

The appellant, a West Virginia corporation, owns and operates a distribution system for natural gas in Eldorado, Kansas. August 17, 1920, rates for supplying local consumers were fixed by order of the Court of Industrial Relations of the State of Kansas, the body then vested with authority in the premises. July 30, 1929, the company filed application with the Public Service Commission, one of the appellees, for an increase, averring that the existing rates were insufficient to produce a fair return, and asking an investigation and the establishment of such as would be just and equitable.

When the order of 1920 was made the appellant was purchasing gas, delivered at the city gate, from Cities Service Gas Company, and still obtains its supply from the same company. The current price is forty cents per thousand cubic feet, which is paid under a day-to-day verbal contract. This rate was originally established by the Public Utilities Commission of Kansas in March, 1923, but its order in that behalf was subsequently rescinded for the reason that Cities Service Gas Company is an interstate carrier and not subject to regulation by the state. The forty cent rate, therefore, is not fixed pursuant to the order or leave of any public authority.

Cities Service Gas Company is the owner and operator of interstate pipe lines and sells natural gas therefrom to various distributing companies. The present corporate relation between appellant and Cities Service Gas Company is as follows: The

common stock of appellant is owned by Gas Service Company, the capital stock of which is in turn owned by Cities Service Company. The common stock of Cities Service Gas Company is owned by Empire Gas & Fuel Company, a controlling interest in the capital stock of which is owned by Cities Service Company. In 1923, when the forty cent rate was put into effect, the distributing companies, including the appellant, were not affiliated with the pipe line company, but in the following years Gas Service Company has acquired control of the appellant and other local distributing companies which are dependent on the pipe line for their supply of natural gas.

Appellant submitted to the Commission a valuation of the property, on which a fair return should be earned. The showing was that there were no net earnings on this value, but an annual loss of approximately $40,000. The total expenses of operation and maintenance of the property for the year ending November 30, 1930, according to the evidence, were $283,049.07, of which far the largest item, $176,260.32, was for gas purchased. In view of these facts, the Commission insisted that in order to determine the reasonableness of the requested increase in retail charges, inquiry must be made as to the propriety of the forty cent rate. The company declined to make any showing with respect thereto, claiming that the Commission was bound to allow it as a proper element of cost in fixing the new retail scale. The Commission dismissed the proceeding. The appellant then filed a bill in the District Court to restrain the further enforcement of the order of August 17, 1920, or the existing rates thereby established, and to enjoin the Commission from interfering with the charging of reasonable rates until such time as some lawful authority, acting in conformity with law, should approve a new schedule, and to prevent the Commission, its members and representatives, from instituting or prosecuting in any court or tribunal proceedings to litigate any of the matters involved in the hearings before the Commission. After answer by the appellees the matter was heard before a court of three judges, constituted as required by § 266 of the Judicial Code, on the pleadings and proofs submitted, and the bill was dismissed on the ground that the appellant had not exhausted its remedy before the Commission. Thereupon this appeal was taken.

First. The appellant asserts that the rate charged by the pipe line company for gas delivered at the city gate is an interstate rate and not the subject of regulation by any state authority. The soundness of this contention is conceded by the appellees. But the appellant argues that any inquiry by the state commission into the reasonableness of this charge amounts to an indirect attempt at regulation, an effort on the part of the state to circumvent the paramount federal authority over interstate commerce, and hence an attempt to do by indirection what is forbidden by the federal constitution. The appellees disclaim any intent to control rates charged for interstate service, but say that as the Commission's function is to set reasonable rates for the intrastate service rendered by appellant in the city of Eldorado, this necessarily requires a determination of the question whether the price paid for the gas distributed is fair and reasonable. To this end the Commission insists upon its authority to make such investigation as will satisfy it upon this point.

Having in mind the affiliation of buyer and seller and the unity of control thus engendered, we think the position of the appellees is sound, and that the court below was right in holding that if appellant desired an increase of rates it was bound to offer satisfactory evidence with respect to all the costs which entered into the ascertainment of a reasonable rate. Those in control of the situation have combined the interstate carriage of the commodity with its local distribution in what is in practical effect one organization. There is an absence of arms' length bargaining between the two corporate entities involved, and of all the elements which ordinarily go to fix market value. The opportunity exists for one member of the combination to charge the other an unreasonable rate for the gas furnished and thus to make such unfair charge in part the basis of the retail rate. The state authority whose powers are invoked to fix a reasonable rate is certainly entitled to be informed whether advantage has been taken of the situation to put an unreasonable burden upon the distributing company, and the mere fact that the charge is made for an interstate service does not constrain the Commission to desist from all inquiry as to its fairness. Any other rule would make possible the gravest injustice, and would tie the hands of the state author-

ity in such fashion that it could not effectively regulate the intrastate service which unquestionably lies within its jurisdiction.

The principles applicable in a rate investigation, where similar corporate relationship existed, were recently announced in *Smith* v. *Illinois Bell Telephone Co.*, 282 U. S. 133, 152-153, and no purpose would be served by repetition or elaboration of what was there said.

Second. It was shown that in proceedings in the state courts of Kansas and in the United States District Court for Kansas, the forty cent wholesale rate had quite recently been held reasonable with respect to sales at the gates of other cities. The decisions in those cases were put in evidence before the Commission, and the contention is that these constituted at least a *prima facie* case for the propriety of the same rate at the city gate of Eldorado. The city, though a party to this proceeding, was not such in the cases mentioned. Obviously it is not bound by the findings made with respect to other cities and towns. Nor is the Commission so bound, for it is admitted that the reasonableness of the rate as respects Eldorado was not in issue in the earlier cases. How much weight the Commission should give to these adjudications we need not here determine. What we do hold is that they do not make a *prima facie* case in support of the charge under attack.

Third. The appellant adverts to the fact that in its bill of complaint are included a number of averments not denied by the appellees. In brief these are that the company does not own or produce any natural gas; that the only source of supply for the city of Eldorado is the main of the Cities Service Gas Company; that no supply at a lower price can be obtained from any other source; that the same rate is being charged to other distributing companies along the lines of the Cities Service Gas Company, and was being charged by another independent pipe line to another city; that an ineffectual effort had been made to find local gas available to Eldorado; and that appellant had attempted to get a lower rate from Cities Service Gas Company but could not do so. It is urged that as these averments were uncontradicted they constitute, when taken with the facts previously stated, a *prima facie* case for the reasonableness of the rate charged. This might well

be true were it not for the fact of unity of ownership and control of the pipe line and the distribution system. An averment of negotiation and effort to procure a reduction in the wholesale rate means little in the light of the fact that the negotiators are both acting in the same interest,—that of the holding company which controls both. All of these facts so averred in the pleadings would be far more persuasive with respect to the propriety of the rate if the parties were independent of each other and dealing at arms' length. Where, however, they constitute but a single interest and involve the embarkation of the total capital in what is in effect one enterprise, the elements of double profit and of the reasonableness of inter-company charges must necessarily be the subject of inquiry and scrutiny before the question as to the lawfulness of the retail rate based thereon can be satisfactorily answered.

Fourth. The argument is made that the proofs demanded by the Commission will involve an extensive and unnecessary valuation of the pipe line company's property and an analysis of its business, and that this burden should not be thrown upon appellant. Whether this is so we need not now decide. It is enough to say that in view of the relations of the parties and the power implicit therein arbitrarily to fix and maintain costs as respects the distributing company which do not represent the true value of the service rendered, the state authority is entitled to a fair showing of the reasonableness of such costs, although this may involve a presentation of evidence which would not be required in the case of parties dealing at arms' length and in the general and open market, subject to the usual safeguards of bargaining and competition.

The judgment of the court below was right and it is

Affirmed.

A true copy.

Test:

Clerk, Supreme Court, U. S.